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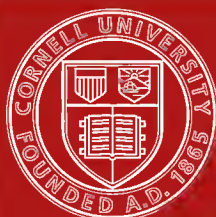
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TREASURY DEPARTMENT
UNITED STATES INTERNAL REVENUE

REGULATIONS NO. 33
(REVISED)

GOVERNING THE COLLECTION OF THE
INCOME TAX

IMPOSED BY THE ACT OF SEPTEMBER 8, 1916
AS AMENDED BY THE ACT OF OCTOBER 3, 1917



WASHINGTON
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1918

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HEAVY

LETTER OF PROMULGATION.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., January 2, 1918.

The following regulations are hereby promulgated for the information and guidance of internal-revenue officers and taxpayers under the authority of acts of September 8, 1916, and of October 3, 1917.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

Approved:

W. G. McADOO,
Secretary of the Treasury.

be accounted for as for the year of the maturity of the share for both the normal and additional tax.

- 19 **Commissions paid salesmen.**—Are income to the salesmen as well as expense to the payer.
- 20 **Compensation.**—For service paid for on a percentage of net profits is income to the employee, and to be accounted for as such.
- 21 **Compensation not paid in money.**—Where service is rendered for a stipulated price, wage, or salary and paid with something other than money, the stipulated value of service in terms of money is the value at which the thing taken in payment is to be considered for the purpose of the income tax.
- 22 Where there is no stipulation as to the value of service and payment for service is made with something other than money, the market or reasonable value of the thing taken in payment is the amount to be included as income for the purposes of the income tax.
- 23 **Executors and administrators.**—If the net income of a decedent from January 1 to the date of his death within that year was \$1,000 or over, if unmarried, or \$2,000 or over if married, a return for such decedent must be made by the executor or administrator, and such executor or administrator may claim all deductions and exemptions to which the decedent would have been entitled under the law.
- 24 **Executors and administrators** whose duty consists of administering on an estate for the purposes of its distribution to heirs or legatees are, during the period of such administration, held to stand in the stead of their principal, and under the provisions of section 2 (b), act of September 8, 1916, are required to make returns of income for the estate and to pay the tax shown by such return to be due.
- 25 **Damages.**—Amount received as the result of a suit or compromise for personal injury, being similar to the proceeds of accident insurance, is to be accounted for as income.
- 26 **Dividend from depletion reserve.**—A reserve set up out of gross receipts and maintained by a corporation for the purpose of making good any loss or wasting of capital assets on account of depletion is not to be considered a part of the earned surplus of the company, but a reserve for the return or liquidation of capital. A dividend paid from such reserve will be considered a liquidating dividend and will not constitute taxable income to the stockholder except to the extent that the amount so received is in excess of the capital actually invested by the stockholder in the shares of stock held by him, and with respect to which the distribution was made. No dividend will, however, be deemed to have been paid from such reserve except to the extent that such dividend exceeds the surplus and undivided profits of the corporation at the time of such payment, and unless the books, records, published statements, etc., of the corporation clearly indicate a corresponding reduction of capital assets resulting from such payment.

Dividends paid with securities.—Dividends declared by a corporation and paid with securities in which the surplus of the corporation has been invested, regardless of the character of such securities, is to be accounted for as a dividend for income-tax purposes by the recipients of same to the extent that it represents a distribution of surplus accrued to the corporation since March 1, 1913. 27

Stock dividends.—Stock dividends declared from a surplus created from the revaluation of capital assets or a value placed upon trademark, good will, etc., do not represent a distribution of earnings or profits subject to tax in the hands of the recipient shareholder. The entire proceeds derived by a shareholder from the sale of such stock is income subject to both the normal and additional tax and shall be accounted for in the shareholder's return rendered for the year in which sold. 28

Farm.—The term "farm" as herein used embraces the farm in the ordinarily accepted sense, plantations, ranches, stock farms, dairy farms, poultry farms, fruit farms, truck farms, and all lands used for similar purposes; and for the purposes of this decision all persons who cultivate, operate, or manage farms for gain or profit, either as owners or tenants, are designated as "farmers." 29

All gains, profits, and income derived from the sale or exchange of farm products, whether produced on the farm or purchased and resold by a farmer, shall be included in the return of income for the year in which the products were actually marketed and sold; and all allowable deductions, including the legitimate expenses incident to the production of that year or future years, may be claimed in the return of income for the tax year in which the right to such deductions shall arise, although the products to which such expenses and deductions are incidental may not have been sold or exchanged for money, or a money equivalent, during the year for which the return is rendered. 30

Rents received in crop shares shall likewise be returned as of the year in which the crop shares are reduced to money or a money equivalent, and allowable deductions likewise shall be claimed in the return of income for the tax year to which they apply, although expenses and deductions may be incident to products which remained unsold at the end of the year for which the deductions are claimed. When farm products are held for favorable market prices, no deduction on account of shrinkage in weight or physical value or losses by reason of such shrinkage or deterioration in storage shall be allowed. 31

Cost of stock purchased for resale is an allowable deduction under the item of expense, but money expended for stock for breeding purposes is regarded as capital invested, and amounts so expended do not constitute allowable deductions, except as hereinafter stated. 32

- 33** Where stock has been purchased for any purpose and afterwards dies from disease or injury or is killed by order of the authorities of a State or the United States and the cost thereof has not been claimed as an item of expense, the actual purchase price of such stock, less any depreciation which may have been previously claimed, may be deducted as a loss. Property destroyed by order of the authorities of a State or of the United States may in like manner be claimed as a loss; but if reimbursement is made by a State or the United States, in whole or in part, on account of stock killed or property destroyed, the amount received shall be reported as income for the year in which reimbursement is made.
- 34** The cost of farm machinery is not an allowable deduction as an item of expense, but the cost of ordinary tools may be included under this item.
- 35** Under paragraph 7 of section 5 (a), act of 1916, providing for "a reasonable allowance for the exhaustion, wear, and tear of property arising out of its use or employment * * *," there may be claimed a reasonable allowance for depreciation on farm buildings (other than a dwelling occupied by the owner), farm machinery, and other physical property, including stock purchased for breeding purposes, but no claim for depreciation on stock raised or purchased for resale will be allowed.
- 36** A person cultivating or operating a farm for recreation or pleasure, on a basis other than the recognized principles of commercial farming, the result of which is a continual loss from year to year, is not regarded as a farmer. In such cases if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from sale of products may be ignored in rendering a return of income, and the expenses incurred being regarded as personal expenses, will not constitute allowable deductions in the return of income derived from other sources.
- 37** An individual engaged in raising and selling stock (cattle, sheep, horses, etc.), is not entitled to claim as a loss the value of such animals raised as die. The cost of raising will have been taken as an expense deduction. In the case of animals purchased, which die, the amount of purchase money will be an allowable deduction, if not previously deducted as a business expense.
- 38** In case of sale the total amount received for stock raised and for stock purchased for resale is to be accounted for as income.
- 39** Orchards and ranches.—Amounts expended in the development of orchards and ranches prior to the time when the productive stage is reached constitute investments of capital.
- 40** Bonus.—Where common stock is received as a bonus in consideration of the purchase of preferred stock, the entire proceeds derived

from the sale or transfer of such stock is income subject to the normal and additional tax.

Gifts.—The fair market price or value of stock acquired by gift subsequent to March 1, 1913, is the basis for computing gain derived or loss sustained by the sale thereof. If acquired by gift prior to March 1, 1913, the fair market price or value as of that date is the basis for computation. 41

Interest on exempt bonds, corporation.—Interest on State, municipal, and United States bonds received by corporations is not taxable to the corporation. Upon amalgamation with other funds of the corporation such income loses its identity. When distributed to stockholders as a dividend, the entire amount of the dividend is subject to inclusion in returns of income for the purposes of the income tax. 42

The foregoing holds true for scrip payment of interest. 43

Value of property acquired by inheritance.—The appraised value at the time of the death of a testator is the basis for determining gain or profit upon sale subsequent to the death after March 1, 1913. 44

Insurance.—Where insured receives, under any form of life insurance, an amount in excess of premiums paid for the insurance, such excess has a taxable status and is to be accounted for as for the calendar year of its receipt. 45

Life insurance.—Dividends on paid-up policies are in the nature of corporate dividends and are to be accounted for as income for the purposes of the additional tax only. 46

Officer or employee of a State.—An individual who enters into a contract with a State, or any political subdivision thereof, for the doing of a thing or things specified by the contract, the completion of which will constitute a fulfillment of the contract on the part of such individual, is not an officer or employee of the State or political subdivision thereof within the meaning and intent of section 4 of the income-tax law and the amount received by him from the State or political subdivision thereof under the terms of the contract is to be accounted for as income. 47

Partnerships.—It is held that the income of a partnership accrues to the individual partner at the time his distributive interest is determined. In the returns of income made by individuals for the calendar year there should be included such incomes accruing from the business of partnerships for the business years of the partnerships as may have been definitely ascertained by means of a book balance, whether distributed or not. Members of partnerships are required to make returns of income, as individuals, for the calendar year, and should include in their returns of income their interest in partnership profits ascertained at the end of the business year falling within the calendar year for which the individual return is being rendered. (See. art. 30.) 48

- 49 **Pensions.**—Pensions paid by the United States, private institutions, or individuals are to be accounted for, for income tax purposes, in all cases where income of the pensioner is liable for income tax.
- 50 **Permanent improvements under lease or rental contracts.**—When improvements become a part of real estate, the difference between cost of the improvements and allowable depreciation during the lease term is gain or profit to the lessor at the end of the lease term and is to be accounted for as income at that time. (T. D. 2442.)
- 51 **Receipt basis.**—Actual receipt is a reduction to possession. Constructive receipt is where income is credited to or made available to recipients and is to be reported as income; as credit to account of recipients of savings-bank interests, etc.
- 52 In the case of compensation for service rendered, where no determination of compensation is had until the completion of the service, the amount received in consideration of the service is income to be accounted for as for the calendar year of its receipt.
- 53 Where the service and payment period is divided by the end of the taxable year, the compensation for the period so divided at the end of the year will be accounted for as income for the year in which payment is actually received. Where the service is compensated by fee, or is of such nature that no part of the fee or compensation becomes due until the completion of the service, the entire amount received should be income to be accounted for as for the year of receipt.
- 54 A person having a salary by the year and in addition commissions on sales, the salary to be paid at the time commissions are determined, and the determination of commissions is in the succeeding calendar year, the entire amount of salary and commissions should be accounted for as income of the calendar year of receipt.
- 55 **Reimbursement.**—Per diem allowance in lieu of subsistence while under traveling orders; the total allowance is income and there may be taken as a deduction for expense the amount actually expended from such allowance for actual necessary traveling expenses.
- 56 **Renewal premium.**—Commissions on renewal premium for insurance received by agents on account of business written is income to be accounted for as such and for the calendar year of its receipt.
- 57 **Bent.**—Amounts expended by tenants for taxes and necessary repairs under agreement, in addition to a stipulated cash rental, are items of taxable income, and as such should be reported in the return of the landlord. A corresponding amount may be deducted by the landlord.
- 58 **Retired pay.**—Retired pay of Army and naval officers and judges of United States courts is subject to the income tax.
- 59 **Royalty.**—Royalty paid to a proprietor by those who are allowed to develop or use property, or operate under some right belonging to him, is to be accounted for as income.

Profit from the sale of stock.—When stock is sold from lots purchased at different times and at different prices and the identity of the lots can not be determined as to dates of purchase, the stock sold shall be charged against the earliest purchases of such stock. The difference between cost and amount realized on the sale will be the profit to be accounted for as income if the purchase was on or after March 1, 1913. Profit derived from the sale of stock purchased prior to March 1, 1913, is the difference between the fair market price or value as of that date and the selling price. 60

Sale of rights.—Amount realized from sale of rights to subscribe to stock is held to be income to the seller. 61

Sale of stock.—When a nonresident alien who owns stock in an American corporation disposes of same by sale, the sale and delivery being made within the United States, the profit will be held to have been derived from sources within the United States and is to be included for the purposes of income tax. 62

Value as of March 1, 1913, method of determining.—No method of determining this value can be stated by the department which will adequately meet all circumstances. What that value was is a question of fact to be established by any evidence which will reasonably and adequately make it appear. 63

EXEMPT INCOME.

Art. 5. There shall not be included as income— 64

(a) The proceeds of life-insurance policies paid to beneficiaries upon the death of the insured. 65

(b) Amount received by the insured, as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or the surrender of the contract. 66

(c) Value of property acquired by gift, bequest, devise, or descent (but income from such property shall be reported as income). 67

(d) Interest on obligations of a State or any political subdivision thereof. 68

(e) Interest on obligations of the United States (but, in the case of obligations of the United States issued after September 1, 1917, only if and to the extent provided in the act authorizing issue thereof),¹ or its possessions. 69

(f) Interest on securities issued under provisions of Federal farm loan act, July 17, 1916. 70

(g) Compensation of all officers and employees of a State or any political subdivision thereof except when such compensation is paid by the United States Government. 71

¹ Interest from United States bonds and certificates, authorized by the act of September 24, 1917, in excess of the interest on an aggregate principal amount of \$5,000 of such bonds and certificates in one ownership must be reported for the purpose of the graduated additional income tax.

- 72 (h) For purposes of income tax under act of October 3, 1917, the compensation of the President of the United States for the term for which he is elected, beginning March 4, 1917 (such compensation being subject to tax under the act of Sept. 8, 1916). Compensation of all judges of the supreme and inferior courts of the United States in office September 8, 1916, and October 3, 1917, compensation of judges of these courts appointed subsequent to September 8, 1916, being subject to tax under act of that date but not under act of October 3, 1917; and compensation of judges of such courts appointed subsequent to October 3, 1917, being subject to tax under both acts.
- 73 **Art. 6.** Net income is the difference between gross income and the sum of allowable deductions.

DEDUCTIONS.

- 74 **Art. 7.** Citizens and resident aliens are given the deductions and credits provided by section 5 of the act of September 8, 1916, as amended by the act of October 3, 1917.
- 75 Nonresident aliens are given deductions and credits as provided by section 6 of that act.

CITIZENS AND RESIDENT ALIENS.

- 76 **Art. 8.** The deductions provided by section 5 of the law are:
- 77 First. Necessary expenses actually paid in carrying on any business or trade, not including personal, living, or family expenses.
- 78 Second. Interest paid within the year except that paid on indebtedness for purchase of obligations or securities, the interest on which is exempt from income tax.
- 79 Third. Taxes: State, or any political subdivision thereof, Federal or foreign (except income and excess profits taxes paid to the United States), and not including taxes assessed against local benefits.
- 80 Fourth. Losses sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty and from theft, when such losses are not compensated by insurance or otherwise.
- 81 Fifth. Losses actually sustained during the year in transactions entered into for profit but not connected with his business or trade to the extent of but not exceeding the profits arising from such transactions.
- 82 Sixth. Debts due to taxpayer actually ascertained to be worthless and charged off within the year.
- 83 Seventh. Depreciation in an amount representing exhaustion from wear and tear of property arising out of its use or employment in business or trade, but no deduction shall be allowed for any amount paid out for new buildings, permanent improvements or betterments

to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made. (See arts. 159, seq.)

The value to be cared for by depreciation is the actual amount invested in the property and not the value which may be arbitrarily or otherwise fixed. 84

Eighth. Depletion: An allowance representing amount of invested capital in quantity of oil, gas, or mineral extracted through wells and mines. 85

Depletion oil and gas wells.—Depletion or return of capital investment in the case of an individual owner or lessee will be calculated in the same manner as provided for corporate owners or lessees. (See arts. 170, 171 and 172.) 86

Ninth. Contributions or gifts, not in excess of 15 per cent of taxable net income, made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual. 87

“Taxable net income” as used in section 5a, ninth deduction, is construed to mean gross income, less deductions (except ninth deduction above) and less excess-profits tax, if any. 88

In connection with claim for this deduction on returns of income there shall be stated: 89

(a) The name and address of each organization to which a gift was made. 90

(b) The date and amount of the gift in each case. 91

Where the gift is other than money, the basis for calculation of the value of the gift shall be the fair market value of the property the subject of gift at the time of the gift. 92

RULINGS AS TO DEDUCTIONS UNDER ARTICLE 8.

Bad debts—Compromise.—Where an indebtedness is claimed and contested and a settlement is had by way of compromise whereby an amount, less than the debt claimed, is accepted in full payment and satisfaction of the debt, the difference between the amount paid and that claimed is not allowable as a deduction for bad debts. Where the settlement in compromise consists of a promise to pay an amount less than the debt claimed, the amount promised to be paid forms the basis of a new transaction, and upon failure to make good this promise the question will arise as to the deductibility of the new amount only. 93

- 94 **Bad debts.**—Where all of the surrounding and attendant circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient showing of the worthlessness of the debt for purposes of deduction.
- 95 **Bad debts.**—A bad debt or worthless debt, as contemplated by the income-tax law and which may be deducted in a return of income, is a debt which has been actually ascertained to be worthless and charged off within the taxable year.
- 96 **Bad debts.**—Debts arising from unpaid wages, salaries, rents, and items of similar taxable income will not be allowed as a deduction unless the income they represent has been included in the return of gross income for the year in which the deduction as a bad debt is sought to be made or in a previous year and the debts themselves have been actually ascertained to be worthless and charged off.
- 97 **Bad debts—Bankruptcy.**—Bankruptcy may or may not be an indication of worthlessness of a debt. Actual determination of worthlessness in such cases is possible only when settlement in bankruptcy shall have been had. Only the difference between the amount received in distribution of assets of the bankrupt and the amount of proved claim may be considered for the purpose of deduction as a bad debt.
- 98 **Bad debts—Foreclosure sale on a mortgage.**—Where, under foreclosure, a mortgagee buys in the mortgaged property and credits the indebtedness with the purchase price the difference between purchase price and the indebtedness will not be allowable as a deduction for bad debt—the property which was security for the debt being in possession and ownership of the mortgagee is, for the purposes of income tax, held to be sufficient to justify a disallowance of a claim for bad debt.
- 99 Only where purchaser for less than debt is another than mortgagee may the difference between debt and net from sale credited be deducted as bad debt.
- 100 **Expense.**—Amounts to be assessed and paid under a mutual agreement between bondholders or stockholders of a corporation, to be used in a reorganization of a corporation, are held to be investments of capital and not deductible for any purpose in a return of income.
- 101 Amounts paid from a salary received for all services rendered, are deductible in returns of income as business expenses, when the expenditures are occasioned by the service in respect of which the salary is paid.
- 102 **Administration expense.**—Expenses of administration of an estate, such as court costs, attorney's fees, executor's commissions, etc., are

chargeable against the corpus of the estate and are not allowable deductions in a return of income.

Expenditures from allowances.—The pay and allowance of Army officers are based on the obligation of an officer to provide equipment and mounts as a personal expense. The cost of mounts and equipment is not therefore a deductible expense. 103

Allowances to minor children.—The father is legally entitled to the service of his minor children. As a rule, allowances which he gives them, whether said to be in consideration of service or otherwise, are not allowable deductions in his return of income nor are they income to the children. 104

Investment of capital.—Amounts expended for securing copyright and plates which remain in possession of and as property of the person making the payments, are investments of capital and can not be allowed as deductions in returns of income. 105

Investment of capital.—Cost of defending title or perfecting title to property, constitutes a part of the cost of the property and is not a business expense. 106

Expense—Capital investments.—The amount expended for architect's service is part of the cost of the building and not a deductible business expense. 107

Expense—Commissions paid.—Commissions paid in purchasing and selling securities are a part of the cost or selling price of the securities and not otherwise deductible. They do not constitute expense deductions in a return of income. 108

Insurance premium.—Premium paid for insurance on property used for business purposes is an allowable deduction. Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense and not deductible. Premium paid for life insurance by the insured is not deductible. 109

Business insurance.—Premiums paid in advance, covering a period of several years, are to be taken as a deduction on the basis of one of two methods: When the books are kept on a cash basis, the entire amount is deductible in the year in which the premium is paid. Where the books are kept on an accrual basis the premium is to be prorated over the period covered by the insurance. 110

Special compensation—Bonus to employees.—Special payments, sometimes denominated gifts or bonuses, made by corporations, partnerships, or individuals to employees, will constitute allowable deductions from gross income in ascertaining net income for the purpose of the income tax, when such payments are made in good faith and as additional compensation for the services actually rendered by the employees. If such payments, when added to the stipulated salaries do not exceed a reasonable compensation for the services rendered, 111

they will be regarded as a part of the wage or hire of the employee, and therefore an ordinary and necessary expense of operation and maintenance, and as such will be deductible from gross income.

- 112 **Expense—Reimbursements.**—Amounts paid out for expense incident to service rendered, and which are reimbursable, are not deductible as expense nor are they to be returned as income when received in reimbursements.
- 113 **Rent or capital investment.**—Where a leasehold is sold for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum, each year, based on the number of years the lease has to run.
- 114 **Rent for residential property.**—In the case of a professional man who rents a property for residential purposes but receives there clients, patients, or callers in connection with his professional work (the place of business being elsewhere), no part of the rent is deductible as business expense.
- 115 **Tenant.**—*Taxes* paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord. The amount of the tax will be deductible by the landlord.
- 116 **Taxes.**—All taxes levied by the general taxing authority, levied and paid on all taxable subjects, including tax imposed and paid under the act of October 3, 1917, except war-excess profits, income taxes, and taxes assessed against local benefits, are allowable deductions to the party paying the same. Although excess-profits tax paid is not an allowable deduction in ascertaining the net income, the net income shown on any return will be credited with the amount of excess-profits tax for which the taxpayer will be liable for the same year, in order to determine the amount of income-tax liability.
- 117 In the case of business, excise, license, or privilege taxes, they may be deducted either as taxes or items of expense, but not under both heads.
- 118 **Tax on bank stock.**—Taxes on bank stock paid under legal requirement by the bank for its stockholders are deductible by the stockholders and not by the bank. Such payments are regarded as in the nature of additional dividends and should be included by the stockholder in his dividends received.
- 119 Where bank stock is sold and transferred between date of assessment and payment of the tax, in the absence of statute governing, the stockholder liable for the tax (if the tax was actually paid) will have the benefit of the tax deduction in returns of income. This is a question of fact and to be determined as such.
- 120 **Loss—Definition.**—The difference between “losses * * * incurred in his business or trade” (4th deduction) and losses “in

transactions entered into for profit but not connected with his business or trade" (5th deduction), is illustrated by the difference between the definitions of "*avocation*": That which takes one from his regular calling; a minor occupation; and "*vocation*": The occupation or pursuit to which one devotes his time or life, a calling. It is possible for a man to give sufficient time, attention, and capital to the pursuit of different lines of business to constitute more than one avenue of "business or trade or employment," *his* business or trade.

Paragraph 4 of section 5 (a), act of September 8, 1916, provides 121 for losses "actually sustained during the year, incurred in *his* business or trade, etc." These would be losses under the head of vocation.

Paragraph 5 of section 5 (a), act of September 8, 1916, provides 122 for losses actually sustained during the year in transactions entered into for profit but not connected with *his* business or trade; that is, losses under the head of "avocation;" that which takes one from his regular calling; a minor occupation. Losses under the head of "avocation" may be deducted "to an amount not exceeding the profits arising from transactions under this head."

Loss—Good will.—Good will does not represent a value attaching 123 to physical property. It is held to be an intangible asset whose value, separate and apart from the business with which it is connected, is not capable of determination. For the purpose of income tax it is capable of neither appreciation nor depreciation. An amount claimed to represent its decline in value is not an allowable deduction from gross income in computing the tax liability of an individual or corporation.

Depreciation—Costumes.—Costumes purchased and used exclusively 124 in the production of a play and which are not adapted for occasional personal use and are not so used are part of the equipment of a business, and as such subject to depreciation in value on account of wear and tear arising from their use in the business, a reasonable allowance for such depreciation may be claimed in returns of income.

Depletion—Timber.—In the case of timberlands, the fair market 125 price or value of timber standing March 1, 1913, or the cost of the timber where the purchase was made subsequent to March 1, 1913, will be the basis for calculation of depletion, and this value as of March 1, 1913, or cost when subsequently purchased, is not to be exceeded for purposes of deduction in returns of income. The whole of such value is to be distributed over the entire amount of standing timber on these respective dates. See Art. 173 of these regulations for rule of calculation.

CREDITS.

- 126 Art. 9. (a) For the purpose of the normal tax only, the income embraced in a personal return shall be credited with the amount received as dividends upon the stock or from the net earnings of any corporation, joint-stock company, or association, trustee, or insurance company, which is taxable upon its net income.
- 127 (b) A like credit shall be allowed as to the amount of income, the normal tax upon which has been paid or withheld for payment at the source of the income under the provisions of Title I of the act of September 8, 1916, as amended, or the act of October 3, 1917, for the purposes of one normal tax only.
- 128 (c) The net income embraced in the return shall also be credited with the amount of any excess-profits tax imposed and assessed for the same calendar or fiscal year upon the taxpayer, and in the case of a member of a partnership with his proportionate share of such excess-profits tax.

NONRESIDENT ALIENS.

- 129 Art. 10. The deductions provided by section 6 for a nonresident alien are:
- 130 First. Necessary expenses actually paid in carrying on any business or trade conducted by him within the United States, not including personal, living, or family expense.
- 131 Second. The proportion of interest paid by him within the year applicable in ascertaining his net income from all sources within the United States, ascertained in accordance with rule prescribed in this paragraph (except interest on indebtedness incurred for purchase of obligations or securities, the interest on which is exempt from income tax), viz: Multiply interest paid on entire indebtedness from all sources by quotient arising from dividing gross income from sources within the United States by gross income from all sources within and without the United States, but this deduction shall be allowed only if such person shall include in his return all the information necessary for its calculation.
- 132 Third. *Taxes*.—State and Federal, but not foreign, paid within the year (except income and excess-profits taxes paid to the United States) and not including taxes assessed against local benefits.
- 133 Fourth. *Losses*.—Actually sustained during the year, incurred in business or trade conducted by him in the United States, and losses or property in the United States from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated by insurance or otherwise.
- 134 Fifth. Losses incurred in transactions entered into in the United States for profit, but not connected with his business or trade in the United States, to an amount not exceeding the profits arising from such transactions.

Sixth. Debts arising in course of business or trade conducted in the United States due to taxpayer actually ascertained to be worthless and charged off within the year. 135

Seventh. Depreciation in an amount representing exhaustion from wear and tear of property within the United States arising out of its use or employment in business or trade, but no deduction shall be allowed for any amount paid out for new buildings, permanent improvements or betterments to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made. The value to be cared for by depreciation is the actual amount invested in the property, and not the value which may be arbitrarily or otherwise fixed. 136

Eighth. (a) *Depletion*.—An amount representing the capital invested in product removed during the year through oil or gas wells or mines within the United States. (b) Depletion can be claimed only by the owner in fee of the mineral interest. Mineral in place being real estate, in all cases where aliens are not permitted to own real estate in the United States without some enabling act making such ownership possible, except upon a showing of title satisfactory to the Commissioner of Internal Revenue, no depletion shall be allowed to a nonresident alien. Upon a satisfactory showing of fee title in a nonresident alien to mineral interest being operated by means of wells or mines, depletion shall be calculated in the same manner as provided in Articles 170, 171, and 172. 137

Art. 11. (a) For the purpose of the normal tax only, the income embraced in a personal return of a nonresident alien individual shall be credited with the amount received as dividends upon the stock or from the net earnings of any corporation, joint-stock company or association, trustee, or insurance company, which is taxable upon its net income. 138

(b) A like credit shall be allowed as to the amount of income, the normal tax upon which has been paid or withheld for payment at the source of the income under the provisions of Title I of the act of September 8, 1916, as amended, or the act of October 3, 1917. 139

(c) The net income embraced in the return shall also be credited with the amount of any excess-profits tax imposed and assessed for the same calendar or fiscal year upon the taxpayer, and in the case of a member of a partnership, with his proportionate share of such excess-profits tax. 140

Art. 12. A nonresident alien may have the benefit of the deductions and credits above provided only by filing or causing to be filed with the collector of internal revenue a true and accurate return of his total income received from all sources, corporate or otherwise, in the United States. In case of failure to file return the tax is to be collected on the gross income from all sources in the United States. 141

142 Art. 13. When all income tax to which income of a nonresident alien is subject is not withheld at the source, a return of income will be required to be filed by or on behalf of said nonresident alien, and penalty for failure to make return in time will attach. All property in the United States of a nonresident alien will be subject to distraint for collection of tax and penalty.

EXEMPTIONS.

- 143 Art. 14. *The exemptions below are given in respect of the normal income tax only.*—They are limited to individuals who are citizens or resident aliens and are provided by (a) section 7, act of September 8, 1916, as amended by the act of October 3, 1917, and by (b) section 3, act of October 3, 1917.
- 144 (a) Under the act of 1916 (sec. 7), for the purpose of the normal income tax, there shall be allowed as an exemption in the nature of a deduction from the amount of net income of each citizen or resident of the United States ----- \$3,000
- 145 (b) An additional \$1,000 is allowed when the person making the return is head of a family or is married and living with husband or wife (as the case may be), in that case making ----- 4,000
(Provided, that only one deduction of \$4,000 shall be made from the aggregate income of both husband and wife when living together.)
- 146 (c) When the person making the return is the head of a family and there are children of the family under 18 years of age, dependent upon such person, or if 18 years of age or over but incapable of self-support because mentally or physically defective and dependent by reason of that fact, there is an additional exemption for each child (to be claimed by person making return and supporting child) ----- 200
- 147 (d) Estates in process of administration, or in trust, the income of which is not distributed annually or regularly (to be claimed by executor, administrator, or trustee) -- 3,000

SECTION 3, ACT OF OCTOBER 3, 1917.

- 148 Section 3, act of October 3, 1917, provides that in case of normal tax imposed by section 1 of that act:
- 149 The exemption of \$3,000 and \$4,000 provided by section 7, act of September 8, 1916, as amended by the act of 1917, shall be, respectively, \$1,000 and \$2,000.

In all cases where under section 7, act of September 8, 1916, as amended, exemptions of \$3,000 or \$4,000 are given in the nature of a deduction for the purpose of the normal income tax, for the purpose of normal tax under the act of October 3, 1917, said exemptions of \$3,000 and \$4,000 are to be, respectively, \$1,000 and \$2,000.

Fiduciaries acting for minors or incompetent persons are permitted to take the personal exemption as to income derived from property of which they have charge in favor of each ward or beneficiary.

RULINGS UNDER ARTICLE 14 AS TO EXEMPTIONS.

DEATH WITHIN THE CALENDAR YEAR.

Where a person having a taxable income dies within the calendar year his personal representative in making return for him will be entitled to claim the full exemption granted by the statutes for the calendar year.

HEAD OF A FAMILY.

A head of a family is a person who actually supports and maintains one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation.

EXCESS.

Personal exemptions from tax are granted in respect of the normal income tax only. Where the total of allowable exemptions and credits exceeds the amount of net income, the excess of such exemptions may not be availed of as against the additional tax.

DEPENDENT CHILDREN.

The exemption of \$200 for each dependent child provided by section 7, act of September 8, 1916, as amended, is given in respect of the income tax and is, therefore applicable under both the act of September 8, 1916, as amended, and the act of October 3, 1917, under the same conditions of fact.

HUSBAND OR WIFE DYING DURING CALENDAR YEAR.

Where a husband or wife having a taxable income dies within a calendar year, and the full exemption for the calendar year is used by the personal representative in making return for the deceased, if the survivor is also required to make a return at the close of the

calendar year for income received within that calendar year the full personal exemption, according to the marital status of the survivor at the close of the calendar year, may be claimed in a return of income.

157 **Art. 15.** Section 1 (*a*), act of September 8, 1916, levies a normal income tax of 2 per cent on the entire net income received in the preceding calendar year from all sources by every individual, a citizen or resident of the United States; and a like tax upon the entire net income received in the preceding calendar year from all sources within the United States by every individual, a nonresident alien.

158 **Art. 16.** Section 1 (*b*), act of September 8, 1916, levies upon the total net income from all sources of every individual, a citizen or resident of the United States, or, in the case of a nonresident alien the total net income received from all sources within the United States, an additional income tax, at the rates therein specified, upon the amount by which such total net income exceeds \$20,000.

159 **Art. 17.** Section 1 of the act of October 3, 1917, levies (*in addition to the normal tax under the act of 1916*), a normal income tax of 2 per cent upon the net income of every individual, a citizen or resident of the United States, received in the calendar year 1917 and every calendar year thereafter. The normal income tax under this section is not levied on the income of nonresident aliens.

160 **Art. 18.** Section 2, act of October 3, 1917, levies (*in addition to the additional tax imposed by section 1 (b), act of 1916*) an *additional tax* upon the total net income in excess of \$5,000 of every individual (citizen, resident, or nonresident alien) at the rates therein prescribed, received in the calendar year 1917 and every calendar year thereafter.

161 **Art. 19.** *Additional tax includes undistributed profits.*

For the purpose of the additional tax, the taxable income of any individual shall include the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint-stock companies or associations, or insurance companies, however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided, or distributed; and the fact that any such corporation, joint-stock company or association, or insurance company, is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a fraudulent purpose to escape such tax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify

that in his opinion such accumulation is unreasonable for the purpose of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint-stock company or association, or insurance company shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed.

Art. 20. Graduated additional tax rates and amounts of income subject 162 thereto—

Amount subject to tax.	Act of Sept. 8, 1916.	Act of Oct. 3, 1917.	Total.
	<i>Per cent.</i>	<i>Per cent.</i>	<i>Per cent.</i>
\$5,000 to \$7,500.....		1	1
\$7,500 to \$10,000.....		2	2
\$10,000 to \$12,500.....		3	3
\$12,500 to \$15,000.....		4	4
\$15,000 to \$20,000.....		5	5
\$20,000 to \$40,000.....	1	7	8
\$40,000 to \$60,000.....	2	10	12
\$60,000 to \$80,000.....	3	14	17
\$80,000 to \$100,000.....	4	18	22
\$100,000 to \$150,000.....	5	22	27
\$150,000 to \$200,000.....	6	25	31
\$200,000 to \$250,000.....	7	30	37
\$250,000 to \$300,000.....	8	34	42
\$300,000 to \$500,000.....	9	37	46
\$500,000 to \$750,000.....	10	40	50
\$750,000 to \$1,000,000.....	10	45	55
\$1,000,000 to \$1,500,000.....	11	50	61
\$1,500,000 to \$2,000,000.....	12	50	62
On excess of \$2,000,000.....	13	50	63

THE RETURN.

Art. 21. The return must be filed after the close of the calendar 163 year and *on or before March 1, annually.*

* * * * * 164

Art. 22. The Commissioner of Internal Revenue may, in his dis- 165 cretion, upon application therefor and upon satisfactory showing, grant a reasonable extension of time, in meritorious cases, for filing returns of income by persons residing or traveling abroad who are required to make and file returns of income and who are unable to file

said returns on or before March 1 of each year. The return may be made by an agent when by reason of illness, absence, or nonresidence the person liable for said return is unable to make and render the same, the agent assuming the responsibility of making the return and incurring penalties provided for erroneous, false, or fraudulent return. In ordinary cases of citizens and residents, where failure to file returns is due to sickness or absence, the Collector of Internal Revenue may in his discretion and on application therefor before expiration of 30 days from the time return should have been filed, allow such further time as he may deem proper (not exceeding 30 days from the date return should have been filed), for making and filing return. The collectors' authority in such cases is limited to 30 days. Further extension can be made by the Commissioner of Internal Revenue only and is confined to meritorious cases and upon satisfactory showing why return was not or can not be made and filed within the extension granted by the collector.

166 **Art. 23.** Forms of returns are provided by the Commissioner of Internal Revenue, and are to be had from the collectors of internal revenue of the several collection districts.

16 **Art. 24.** An individual keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect his income may, subject to regulations made by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, make his return upon the basis on which his accounts are kept.

168 **Art. 25.** The annual returns will be forwarded by collectors by registered mail or express to the Commissioner of Internal Revenue with the list for the month in which the returns are filed. Collectors must provide that said returns and all forms relating thereto are securely sealed in envelopes or packages before forwarding the same.

Art. 26. In the case of citizens and resident aliens—

Returns are required of all unmarried persons of lawful age having a net income of \$1,000 or over.

And of all married persons having a net income of \$2,000 or over.

Heads of families who are married will be required to make returns of income when having a net income of \$2,000 or over.

Heads of families who are unmarried will be required to make returns of income when having a net income of \$1,000 or over, though the basic exemption which may be claimed in a return of income will be \$2,000.

170 Under the act of September 8, 1916, as amended, and the act of October 3, 1917, returns will be required in the case of net incomes

equal to or in excess of \$1,000 or \$2,000, according to the marital status of the person making the return. In the returns so required the basic personal exemptions will be \$1,000 under the act of October 3, 1917, and \$3,000 under the act of September 8, 1916, as amended. The exemption allowed husband and wife living together may be taken by one or divided between them in such ratio as they may determine.

RULINGS ON MAKING RETURNS.

Receipt and payment basis.—Returns should be made on the basis of receipt unless the individual liable for the return keeps accounts on some other basis which will clearly reflect his income. 171

Where filed.—Returns of income of individuals are to be filed with the collector of internal revenue for the district in which such person has his legal residence or principal place of business, or if there be no legal residence or place of business in the United States, then with the collector of internal revenue at Baltimore, Md. The returns shall be in such form as shall be prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury. 172

On basis of calendar year.—Returns of individuals can not be accepted prior to the close of the calendar year. The exception, in cases of closed administration, is a matter of convenience to those concerned and is granted by reason of the fact that the period to be covered by the return has completely elapsed. 173

Place of filing.—Persons in the military or naval service of the United States may file their returns of income with the collector of internal revenue of the district in which they have a legal residence, or with the collector of internal revenue at Baltimore, Md. 174

Verification of.—All income-tax returns must be verified under oath or affirmation. Persons in the naval or military service of the United States may verify their returns before any official of those services authorized to administer oaths for the purposes of those services. 175

Income-tax returns executed abroad may be attested free of charge before United States consular officers. 176

Where a foreign notary or other official having no seal shall act as attesting officer, the authority of such attesting officer should be certified to by some judicial official or other proper officer having knowledge of the appointment and official character of the attesting officer. 177

Income from exempt securities.—Where the entire income of an individual is from tax-exempt bonds and where the amount of income other than that from tax-exempt securities is less than the amount of income for which a return is required, no return of income is to be made. Interest from securities which is exempt from tax under sec- 178

tion 4 of the Income Tax Law is not to be included in returns of income.

- 179 **Administrator or executor.**—Administrators or executors may, immediately after their discharge, upon final accounting, file with the proper collector of internal revenue a return of income for the income of the estate for the calendar year in which the administration was closed, and should pay the tax found by such return to be due immediately upon receipt of notice and demand for the amount of such tax. There should be attached to this return a copy of the certificate, under seal, setting forth the fact of final accounting and discharge of the executor or administrator. The liability for return is fixed by the law as of December 31, and return will be required in accordance with the provisions of law existing on that date.
- 180 An ancillary administrator is held to be merely an agent of the domiciliary administrator and should transmit to him all information as to income of the estate received by the ancillary administrator, to the end that the original administrator may make a return covering the entire income of the estate.
- 181 Receivers who, as officers of a court, stand in the stead of some principal are required to account for income tax as the principal would have been required to account.
- 182 **Husband and wife filing separate.**—Where husband and wife file separate returns of income, one of them being filed in time and the other delinquent, such returns are not supplemental of each other and delinquency must be answered for by the one in connection with whose return it occurred.
- 183 **Wife's income.**—Unless the wife has a separate estate which requires her to file a separate return of income, or to join with her husband in a return which shall set forth her income separately, her husband should include in his return the income accruing to the wife from services rendered by her, or the sale of product of her labor. The actual proceeds coming into the wife's possession during the tax year constitute the income to be included, and not the amount estimated upon acceptance prior to payment for articles sold.
- 184 **Inspection of.**—An executor acts for his principal and not for the beneficiaries of the estate of his principal. Beneficiaries are not entitled, as such, to an inspection of returns of income filed by such executor.

FIDUCIARIES.

- 185 **Art. 27.** Fiduciaries acting for minors or other incompetents will be required to make returns of income according to the marital status of the beneficiaries, and in all cases of return under section 2 (b), act of September 8, 1916, as amended, when the income of the estate

or trust, as an entity, is \$1,000 or over. This return will be on Form 1040 or 1040A.

Fiduciaries are required to make returns of income on Income Tax Form 1041 whenever the interest of any beneficiary in the net income of an estate or trust for which the fiduciary acts is \$1,000 or over for an unmarried beneficiary, and in case there are married beneficiaries, then a return will be required whenever the interest of any such married beneficiary is \$2,000 or over.

Art. 28. Where the beneficiary is a nonresident alien individual the tax imposed by the act of September 8, 1916, as amended, and the act of October 3, 1917, is to be accounted for by such fiduciary on a return of income for such nonresident alien beneficiary on Income Tax Form 1040 or 1040A, as the case may be.

Art. 29. Fiduciaries will be subject to all the provisions of law which apply to individuals who are required to make returns of income. A fiduciary making return shall make oath that he has sufficient knowledge of the affairs of the person, trust, or estate for whom or which he acts to enable him to make such return, and that the same is, to the best of his knowledge and belief, true and correct. A return by one of two or more joint fiduciaries in the form prescribed filed in the district in which such fiduciary resides shall be a sufficient compliance with the requirement for fiduciary return.

“Fiduciary” is a term which applies to all persons or corporations that occupy positions of peculiar confidence toward others, such as trustees, executors, or administrators; and the fiduciary for income-tax purposes is any person or corporation that holds in trust an estate of another person or persons.

There may be a fiduciary relationship between an agent and a principal, but the word “agent” does not denote a “fiduciary” within the meaning of the income-tax law.

Power of attorney.—A fiduciary relationship for the purposes of the income tax can not be created by a power of attorney. An agent having entire charge of property with authority to effect and execute leases with tenants entirely on his own responsibility and without consulting his principal, paying taxes and expenses and all other charges in connection with the property out of funds in his hands from collection of rents, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by a power of attorney, is not a fiduciary within the meaning of the income-tax law. In all cases where no legal trust has been created in the estate controlled by the agent and attorney the liability under the law rests with the principal.

Trust estates as entities.—Where income under the provisions of section 2(b), act of September 8, 1916, is accounted for in a return of income by the executor, administrator, or trustee, as the case may

be, and the tax shall have been assessed and paid under such return, such income is thereby freed of all tax liability and may be thereafter dealt with without further regard to the provisions of the income-tax law.

- 193 Under the provisions of section 2(b) it is held that estates during the period of administration have but one beneficiary, and that beneficiary is the estate. Therefore a return on Form 1040 or 1040A, subject to all the deductions and exemption, shall be made by the executor or administrator for such beneficiary and the entire tax paid thereon.
- 194 **Deed of trust.**—A deed of trust must be absolute so far as the conveyance of title is concerned and irrevocable by the donor, otherwise the income from the property in question will accrue to the donor and must be accounted for by him.
- 195 **Executors and administrators.**—Where, during the period of administration, an executor converts the estate in his possession as such executor into money for the purpose of settling the estate and closing the administration and in which conversion a profit is realized which with other income exceeds \$1,000 a return of income should be made by the executor covering the period of administration in which should be included all gains, profits, and income of the estate during such period, and he should pay the tax found by such return to be due. The income of the estate being thus freed of income-tax liability may thereafter be dealt with without further regard to income-tax requirements.
- 196 Proceeds of life insurance policies payable to the estate of a decedent, when received by an executor or administrator, are, in the amount by which such proceeds exceed the premium or premiums paid by the decedent, income of the estate to be accounted for by the executor or administrator under the provisions of section 2 (b), act of September 8, 1916. This return is to be made on income-tax Form 1040 or 1040A.
- 197 **Administrator or executor.**—Liability for payment of income tax attaches to the person of an executor or administrator for income tax up to and including the date of his discharge, regardless of the fact that the time in which claim is made and filed against the estate has expired or where, prior to distribution and discharge, the executor or administrator had notice of his obligations to the Federal Government or where he failed to exercise due diligence in determining whether or not such obligations existed.
- 198 Liability for the tax due from a deceased person, or from his estate, also attaches to the estate itself, and when by reason of distribution of the estate and discharge of the executor or administrator it shall appear that collection of the tax can not be made from the executor

or administrator, the collector will make demand on the distributees for their proportionate share of the tax due and unpaid.

Depreciation deduction in return of.—In the case of a trust estate 199 where the terms of the will or trust or the decree of a court of competent jurisdiction provides for keeping the corpus of the estate intact, and where physical property forming a part of the corpus of such estate has suffered depreciation through its employment in business, a deduction from gross income for the purpose of caring for this depreciation, where the deduction is applied or held by the fiduciary for making good such depreciation, may be claimed by the fiduciary in his return of income. Fiduciaries should set forth in connection with their returns the provision of law, trust, or decree requiring such depreciation deduction where any exists or when actual depreciation occurs, the amount thereof, and that the same has been or will be preserved and applied as such. All amounts paid by fiduciaries to beneficiaries of trust estates from the income of such trust estates, whether from reserves or otherwise, are held to be distributions of income and will be treated for income-tax purposes in accordance with the provisions of law and regulations applicable to income of such beneficiaries.

Nonresident alien beneficiary.—Where a fiduciary in the United 200 States is the recipient of trust income for which there is but one beneficiary and that beneficiary a nonresident alien, the fiduciary will be required to make full and complete return on Income Tax Form 1040 or 1040A, as the case may be, for this trust income on behalf of the nonresident alien and pay any and all tax found by such return to be due. Where there are two or more beneficiaries, one or all of whom are nonresident aliens, the fiduciary shall render a return on Form 1041, and a personal return on Form 1040 or 1040A for each nonresident alien beneficiary.

Parent—Minor child.—The parent is held to be the natural guardian 201 of a minor child. Income received by the minor child from sources other than the parent should be included by the parent in his return of income. The fact that such income is not appropriated by the parent is immaterial, as it will be held, in the absence of a showing of fact to the contrary, that such income was subject to appropriation and was appropriated by the parent, and that the child receives the same as a gift from the parent. Where the income is from a separate estate and the parent has been appointed guardian and the conditions are such that the income so received is to be held for the use of the child, it shall not be included in the return of income of the parent, but shall be accounted for otherwise for the purposes of the income tax in manner and form as called for by the facts of the particular case.

- 202 Trust, return of.—Where, in the case of more than one trust, the creator of the trust in each instance is the same person and the trustee in each instance is the same, the trustee should make a single return on Form No. 1041 for all of the trusts in his hands, notwithstanding the fact that they arise from different instruments. When a trustee holds trusts created by different persons for the benefit of the same beneficiary, he should make return for each trust separately on Form No. 1041. This ruling is based on the identity of the creator and the identity of the trustee of the various trusts, and not upon the identity of the beneficiary.
- 203 Incompetents.—A committee of the property of an incompetent person is held to be a fiduciary for the purpose of income tax and required to make a return on Form 1040, revised, for the incompetent whenever the amount of income is sufficient to require a return.
- 204 Two estates.—A fiduciary acting for a beneficiary in more than one estate or trust is required to account for each estate separately when the amounts are such as to require the filing of a return, and also a return of information.
- 205 A fiduciary acting for a minor or insane person having a net income of \$1,000 or \$2,000, according to the marital status of such person, will be required to file a return for such incompetent on Form 1040 and 1040A and pay the tax found by such return to be due, in addition to the requirement in the preceding paragraph when there is more than one beneficiary of the income of the same trust.
- 206 Stock dividends paid from earnings or profits accumulated after March 1, 1913, received by a fiduciary and retained as an accretion to the estate under the *terms* of the *will* or *trust* are held to be income to the estate and taxable as such to the estate.
- 207 Income accumulated in trust for unascertained persons or persons with contingent interests is held to be income accruing to the estate and is taxable to the estate.
- 208 Income held for future distribution under the terms of the will or trust shall be likewise taxed except when returned by the beneficiary for the purpose of the tax.
- 209 All fiduciaries are indemnified against the claims or demands of every beneficiary for all payments of taxes which they shall be required to make under the provisions of this title and they shall have credit for such payments in any accounting which they make as such fiduciaries.
- 210 The beneficiary will be required in the case of trust estates to account for the actual amounts distributed or credited to him.
- 211 Art. 30. Partnerships.—Partnerships as such are required to make return of income for income-tax purposes only when requested so to do by the commissioner or collector, and when so requested they shall render a correct return of the earnings, profits, and income

of the partnership, except income exempt from tax under section 4 of the income-tax law, setting forth the item of gross income and the deductions and credits allowed by law as for an individual, citizen, or resident alien, and the names and addresses of the individuals who would be entitled to the net earnings, profits, and income, if distributed. In computing its profits, for the purpose of the income tax and return as aforesaid, a partnership shall not deduct premiums on life-insurance policies covering the lives of members of the partnership, its employees, or those financially interested in the business or trade conducted by the partnership or otherwise. Individuals entitled to share in partnership net income are required to include in their returns of income their respective shares of such partnership net income, whether distributed or not. In reporting their share of partnership net income the partners will exclude such part thereof as may have been received by the partnership from sources exempt from tax under provisions of section 4, act of September 8, 1916, as amended, and which shall have been included by the partnership in its statement of net income distributed to the partners. The partners shall include in their returns of income their proportionate share of partnership net income derived from dividends, but the amount of such dividends so received shall be allowed as a credit for the purpose of computing the normal income tax. Partnerships having a net income of \$6,000 or over will be required to render returns for the purpose of excess-profits tax.

Insurance premiums.—Insurance premiums paid on life-insurance 212 policies covering the lives of officers, employees, or those financially interested in any business conducted as a partnership or by an individual shall not be deducted in computing the net income of such individual or in computing the profits of such partnership for the purposes of paragraph (e) of section 8 of the act of September 8, 1916, as amended.

Identity of income.—The character of partnership profits divisible 213 between persons has no reference (except as otherwise specially provided for in sec. 8 (e), act of Sept. 8, 1916, as amended) to any character which, as income accruing to the partnership it may have borne prior to the receipt by the partnership, and hence, with the exception noted, income received from a partnership can not be traced to its source behind the partnership for the purpose of claiming individual exemption. Where the result of partnership operation is a net loss, the loss will be divisible between the partners in the same proportion as net income would have been divisible, and may be used by the individual partners in their returns of income.

Art. 31. A partnership shall have the privilege of fixing and mak- 214 ing return on the basis of a fiscal year the same as provided for cor-

porations by section 13 (a) and (3), act of September 8, 1916, as amended. If the fiscal year of a partnership (other than the calendar year) ends in a calendar year for which there is a rate of tax, different from the rate for the preceding calendar year, for the purpose of the income tax, each partner's share of partnership profits shall be divided in the proportion of the different calendar years composing said fiscal year and the rate of tax for the respective calendar years shall apply to that part of such profits as thus falls within said calendar years.

215 Any partnership may at its option designate the last day of any month as the close of its fiscal year. In each case where the partnership's fiscal year differs from the calendar year it shall, not less than 30 days prior to March 1, give notice in writing to the collector of internal revenue of the district in which its principal place of business is located that the day it has thus designated is the closing day of its fiscal year.

216 **Art. 32. Nonresident alien individuals.**—A nonresident alien individual shall make a full and accurate return of all net income received from sources within the United States, regardless of amount, unless the tax on such income has been fully paid at the source; and is not entitled to the benefit of the several deductions and credits provided by section 6 of the act of September 8, 1916, as amended by the act of October 3, 1917, unless such return is filed by him or his authorized agent.

217 **Return of income.**—Nonresident aliens are not entitled to any specific exemption as a deduction from net income from sources within the United States. The responsible heads or representatives of nonresident aliens in connection with any sources which said nonresident aliens may have within the United States, shall make a full and complete return of such income and shall pay any and all tax, normal and additional, assessed upon the income received by them in behalf of their nonresident alien principals, in all cases where the income tax on income so in their receipt, custody, or control shall not have been withheld at the source.

218 Where nonresident aliens have various sources of income within the United States so that at any one source or from all sources combined, the amount of income shall call for the assessment of additional tax and a return of income shall not be filed by or on behalf of a nonresident alien for the purpose of the assessment of income tax, the Commissioner of Internal Revenue will cause a return of income to be made and include therein the income of the nonresident alien from all sources concerning which he has information and shall assess the tax and collect the same from one or more or all of the sources of income within the United States of said nonresident alien, without allowance for deductions and credits under section 6.

Payment of tax on.—Income derived by nonresident aliens from 219 sources in the United States is subject to the normal or additional tax, or both, as the case may be, and said tax shall be paid by the owner of said income, or the proper representative of the nonresident alien having the receipt, custody, control, or disposal of the same. In all cases the proper representative in the United States of a nonresident alien, with respect to such income, shall make return for such nonresident of all such income coming into his custody or control and pay the tax thereon as provided by law; provided, however, where all income shall have been paid over by the representative to his principal on or before October 3, 1917, under the law and income tax regulations in force up to that date, or where the stockholder of record shall not—between October 3 and December 31, 1917—be in receipt of or have in his custody or control income the property of his said principal, such representative will be relieved from paying said tax, leaving the same a charge against the nonresident alien and to be collected from him by any means at the disposal of the Commissioner of Internal Revenue; but where such representative shall have in his possession, custody, or control subsequent to October 3, 1917, income of such nonresident alien, said representative shall pay the total tax due upon the income of such nonresident alien so in his custody and control for the entire year 1917 and subsequent years.

Exempt income.—Nonresident aliens will not be required to make 220 return of any of the classes of income specified by section 4, act of September 8, 1916, as amended, and received by them from sources in the United States. (See art. 5.)

RULINGS UNDER ARTICLE 32.

Salary, rents, etc.—It is held that salaries, wages, commissions, and 221 rents paid by domestic corporations, resident individuals, or partnerships to nonresident alien employees for services rendered entirely in a foreign country and for property located in a foreign country are not subject to deduction and withholding of the normal tax and such payments of income will not be subject to the income tax in the hands of the recipient as from a source within the United States.

Refund, on return.—Where, upon filing return of income, it ap- 222 pears that a nonresident alien is not liable for income tax, but, nevertheless, income tax shall have been withheld at the source, in order to obtain a refund on the basis of the showing made by the return there shall be attached to the return a statement showing accurately the amounts of tax withheld, with the names and post-office addresses of all withholding agents.

Return by agent.—The agent of a nonresident alien is responsible 223 for a correct return of all income accruing to his principal within the

purview of the agency, and the agent will be held responsible for a complete return of all such income. The agency appointment will determine how completely the agent is substituted for the principal for income-tax purposes.

- 224 **Foreign corporations—Dividends on stock.**—Dividends on stock of domestic corporations or resident alien corporations are held, prima facie, to be income of the record owner of the stock, and such record owner will be liable for the income tax, normal or additional, according to his or its individual or corporate status unless a disclosure of actual ownership is made to the Commissioner of Internal Revenue which shall show who the owner is and his address, and that the record owner is not the actual owner.
- 225 When the record owner of such stock is a nonresident alien corporation, etc., not having an office or place of business in the United States, the debtor corporation will withhold the normal income tax and pay the same to the proper officer of the United States authorized to receive it in manner and form provided for withholding and accounting for tax withheld.
- 226 In all cases where the actual owner is a nonresident alien individual or corporation, and the record owner is an individual, firm, or corporation in the United States (a citizen or resident alien), and the aforesaid showing of actual ownership is made, the record owner will be held, for income-tax purposes, to have the receipt, custody, control, and disposal of the dividend income and will be required to make return for the actual owner and pay the tax found by such return to be due. Where the actual owner is a nonresident alien corporation, return will be made regardless of the amount of dividend and the normal income tax will be paid, and when the actual owner is a nonresident alien individual, a return shall be made regardless of the amount of the income, and when the net amount of such income exceeds \$5,000 said custodian shall also pay the additional tax on such income. When it shall appear from the disclosure herein provided for that the actual owner is a nonresident alien partnership, all certificates making such disclosure shall be transferred to the Commissioner of Internal Revenue for the information of the collector of internal revenue, but no return will be made for such partnership and no amount will be retained from such income by the representative of such partnership in the United States unless and until such representative shall be so instructed by the Commissioner of Internal Revenue. When a nonresident alien record owner of stock of domestic or resident corporations is an organization subject to withholding at the source of dividend payments, but is not the actual owner of the stock, such record owner may make disclosure, in form prescribed by the Commissioner of

Internal Revenue, of actual ownership, in which case said domestic or resident corporations will be governed by the established facts.

If the record owner does not exercise his right to disclose actual 227 ownership for the purpose of claiming exemption from having tax withheld at the source, debtor corporations and their withholding agents in the United States will be held liable on their stock records of ownership for the tax required to be withheld by section 13 (*f*) of the act of September 8, 1916.

In the absence of disclosure of actual ownership filed with debtor 228 corporations or their withholding agents, in manner and form provided for, the normal tax required to be withheld in accordance with stock records of ownership can only be released to a record owner not liable for tax upon a proper showing to the Commissioner of Internal Revenue of record and actual ownership, the names and post-office addresses of debtor corporations and withholding agents, and the amounts withheld.

The record owner is held to be "the proper representative having 229 the receipt, custody, control, or disposal" of income of the actual owner and is required to file a return for or on behalf of the actual owner for the purpose of assessment of income tax not withheld at the source.

When a return is not required to be filed by or on behalf of the 230 actual owner, the showing may be made upon the certification of the record owner.

Upon the showing thus made, either by certification or return, as 231 the circumstances may require, the Commissioner of Internal Revenue will make such assessments and issue such instructions to debtors and withholding agents as will insure the proper collection of tax in accordance with the respective tax liabilities.

INFORMATION AT THE SOURCE.

Art. 33. Every person, corporation, partnership, or association 232 doing business as a broker on any exchange or board of trade or other similar place of business, shall, upon request of the Commissioner of Internal Revenue, render a correct return under oath, on a form furnished by the Commissioner of Internal Revenue for that purpose, showing the names of customers for whom such person, corporation, partnership, or association has transacted any business, with such details as to the profits, losses, or other information as may be called for by such return form as to each of such customers. See special regulations No. 40.

Art. 34. Every person, corporation, partnership, association, and 233 insurance company, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust

capacity, executors, administrators, receivers, conservators, and employers, making payment to another person, corporation, partnership, association, or insurance company of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable gains, profits, and income (other than payments coming within the paragraph next above and dividend payments under sec. 26) of \$800 or more, in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments, are hereby authorized and required to render a true and accurate return to the Commissioner of Internal Revenue, on the form prescribed for that purpose (Form 1099), setting forth the amount of such gains, profits, and income and the name and address of the recipients of such income.

234 Letter of transmittal.—Returns of information for the preceding calendar year shall be filed with the Commissioner of Internal Revenue on or before March 1 of each year, accompanied by a letter of transmittal, under oath (Form 1096), which will show the number of returns filed and the aggregate amount represented by the payments.

235 Salary and commission.—Where a person receives a cash compensation for services rendered and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax. A return under section 28 is required in each case where the cash compensation received plus the value of living quarters furnished equals or exceeds \$800 for a tax year.

236 Art. 35. Such returns of information shall be required, regardless of amount, in the case of payments of interest upon bonds, mortgages, or deeds of trust or other similar obligations of corporations, joint-stock companies, associations, and insurance companies; and in the case of collection of items (not payable in the United States) of interest upon the bonds of foreign countries and interest on the bonds and dividends on the stock of foreign corporations by persons, corporations, partnerships, or associations undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

237 In the case of items (payable in the United States) of interest upon bonds of foreign countries and interest upon bonds and dividends from stocks of foreign corporations the fiscal agent in the United States will be the source for purposes of information. If no ownership certificate is received with the item, the first bank or collection agent receiving the same shall execute a certificate, Form 1001, showing the name and address of the owner, if known, or the person presenting the item, which certificate shall be forwarded to the fiscal

agent in the same manner as if the certificate had been signed by the owner.

In the case of such foreign items (not payable in the United States) the same may be accepted for collection only by a licensed bank or agent, and the latter will be held to be the source for the purposes of the return of information.

The original ownership certificates, accompanied by the monthly list returns, in the case of interest on bonds of domestic and resident corporations, when filed with the Commissioner of Internal Revenue shall constitute and be treated as returns of information.

Art. 36. When the person receiving a payment falling within the provisions of law for information at the source is not the actual owner of the income received, the name and address of the actual owner shall be furnished upon demand of the person, corporation, partnership, or association paying the income, and in default of a compliance with such demand the payee becomes liable to a penalty of not less than \$20 nor more than \$1,000.

Art. 37. The requirement of law for information at the source shall not apply to the payment of interest on obligations of the United States.

ASSESSMENT OF TAX.

Art. 38. The assessment of income tax shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are, respectively, liable on or before the first day of June of each successive year.

Three years' limitation.—The statute (sec. 9 (a), act Sept. 8, 1916) does not require the assessment to be made within three years from the time a return was due. The limitation is upon the discovery of delinquency or error, within three years.

Amended return.—Where a further tax is found to be due as result of audit of a return or agent's report, an amended return or waiver will not be required, except where the discovery of the tax is made subsequent to the expiration of the three-year period of limitation.

Effective date of Treasury decisions.—Treasury decisions promulgating rulings of the Internal Revenue Bureau become effective upon the date of approval unless otherwise stated therein. Cases previously adjusted in contravention of law as pronounced in such decisions, are subject to readjustment in accordance with the decision.

COLLECTION OF THE TAX.

Art. 39. The tax is to be paid upon notice from a collector of internal revenue of the amount of tax due and at all events not later than June 15. As to all tax unpaid on June 15 and for 10 days

after notice and demand therefor, the penalty is 5 per cent of the amount of the tax unpaid and interest at the rate of 1 per cent per month upon such tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons.

- 247 **Payment of taxes.**—An excess payment of tax in one year can not be offset against an assessment of tax for a subsequent year.
- 248 **Status of income tax.**—Tax due on income has the status of a debt due to the United States. Persons receiving property charged with such indebtedness must answer for the debt.
- 249 **Art. 40.** Section 1009, act of October 3, 1917, provides that taxpayers liable for income and excess-profits tax may make payments of such taxes in advance, in installments or in whole of an amount not in excess of the estimated taxes which will be due from them and upon determination of the taxes actually due any amount paid in excess shall be refunded as taxes erroneously collected, and credit against such tax so paid in advance may be allowed of an amount not exceeding 3 per cent per annum calculated upon the amount so paid from the date of such payment to the date now fixed by law for such payment; but no such credit shall be allowed on payments in excess of taxes determined to be due, nor on payments made after four and one-half months after the close of the taxable year. In case of undertaking to pay tax in installments and default of any installment the penalty for failure to pay tax when due will attach.
- 250 **Rules for calculation of the 3 per cent credit on account of advance payment of tax, or a reduction otherwise of the amount of tax assessable on a return of income by means of advance payment, have been prescribed by the Secretary of the Treasury by special regulation. (T. D. 2622.)**
- 251 **Art. 41.** In the payment of income tax a fractional part of a cent shall be disregarded unless it amounts to a half cent or more, in which case the fraction shall be increased to 1 cent.
- 252 **Form 17.**—Collectors should issue Form 17 for the purpose of fixing definitely the date when the 5 per cent penalty accrues and interest at 1 per cent per month begins to run, and a copy of this notice should be filed as provided by act of August 17, 1912, amending section 3186, Revised Statutes.

PROCEDURE IN CASES OF DELINQUENCY.

- 253 **Art. 42.** In cases of refusal or neglect to make return and in cases of erroneous, false, or fraudulent returns the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due or has been made make a return of income upon information obtained as provided for by law, or require the necessary corrections to be made, and the assessment

made by the Commissioner of Internal Revenue thereon shall be paid by such person or persons immediately upon notification of the amount of such assessment. If the amount of such assessment remains unpaid for 10 days after notice and demand therefor by the collector, there shall be added the sum of 5 per cent on the amount of tax unpaid and interest at the rate of 1 per cent per month upon such tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons.

WITHHOLDING.

Art. 43. The withholding provisions of the income-tax law (secs. 254 9 (b) and (c) apply—

(a) To the normal income tax levied upon the entire net income 255 of nonresident aliens, of a fixed or determinable annual or periodical class, as interest, rent, salary, wages, etc., received by them from all sources within the United States. This tax is 2 per cent under the act of September 8, 1916 (there is no exemption and none can be claimed).

(b) To the normal income tax of citizens and resident aliens, 256 only when derived from interest on bonds and mortgages, deeds of trust, or other similar obligations of corporations, associations, etc., which have a "tax-free covenant clause (i. e., a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee or to reimburse the obligee in any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the United States), regardless of the amount and period of payment.

The amount to be withheld is 2 per cent on the amount of pay- 257 ment, unless the person entitled to receive such interest shall file with the withholding agent, on or before February 1, a signed notice in writing claiming the benefit of an allowable exemption under section 7, act of September 8, 1916, as amended.

(c) The tax to be deducted and withheld from nonresident alien 258 individuals in accordance with section 9 (b) and (c) for 1917 and subsequent tax years is the 2 per cent normal tax imposed by the act of September 8, 1916, as amended.

On and after January 1, 1918, the normal tax of 2 per cent im- 259 posed by the act of October 3, 1917, is the tax to be deducted and withheld from citizens or residents of the United States in accordance with section 9 (c).

Tax withheld from income other than bond interest will be ac- 260 counted for on income-tax Form 1042, and separate reports of the

payments entered on Form 1042 will be made on Form 1098. The amount withheld from bond interest will be accounted for monthly on income-tax Form 1012, and an annual summary of these will be made on income-tax Form 1013. The annual return only will be verified.

261 Ownership certificates.—The owners of bonds of domestic and foreign corporations shall, when presenting interest coupons for payment, file a certificate of ownership for each issue of bonds, showing the name and address of the debtor corporation, the name and address of the owner of the bonds, whether the payee is married or the head of a family, and the amount of interest.

262 Tax to be paid at the source.—Form 1000, revised, shall be used (a) when no personal exemption is claimed against interest on bonds containing a “tax-free” covenant by citizens or residents of the United States; (b) by nonresident alien individuals, foreign corporations having no office or place of business in the United States whether or not such bonds contain a “tax-free” covenant; and (c) in the case where coupons are received not accompanied by certificates of ownership. The first bank receiving coupons not accompanied by ownership certificates will make a certificate crossing out “owner” and inserting “payee” and will enter the amount of interest on line 4.

263 Tax not to be paid at the source.—Form 1001, revised, shall be used (a) when personal exemption is claimed against interest on bonds containing a “tax-free” covenant by citizens or residents of the United States, also when presenting coupons from bonds not containing a “tax-free” covenant; (b) by domestic partnerships, corporations, or associations; (c) by nonresident alien partnerships; and (d) by foreign corporations having an office or place of business in the United States, whether or not such bonds contain a “tax-free” covenant.

264 In case a citizen or resident individual receives interest on bonds containing a “tax-free” covenant in excess of the amount of personal exemption which the individual may claim, any such excess must be reported on Form 1000, revised.

265 Substitute certificates.—Collecting agents, responsible banks and bankers receiving coupons for collection with ownership certificates attached may present the coupons with the original certificates to the debtor corporation or its duly authorized withholding agent for collection or the original certificates may be detached and forwarded direct to the Commissioner of Internal Revenue, provided such collecting agent shall substitute for such certificate its own certificate and shall keep a complete record of each transaction showing—

- 266**
1. Serial number of item received.
 2. Date received.

3. Name and address of person from whom received.
4. Name of debtor corporation.
5. Class of bonds from which coupons were cut.
6. Face amount of coupons.

For the purpose of identification the substitute certificates shall 267 be numbered consecutively and corresponding numbers given the original certificates of ownership.

Substitute certificates by collecting agents, banks, and bankers, in 268 lieu of original certificates of ownership accompanying coupons presented for collection shall be discontinued with respect to ownership certificates presented with coupons for collection by nonresident alien individuals, firms, corporations, organizations, etc.

In all such cases the original certificates of ownership shall be 269 forwarded to the debtor corporation without substitution.

The debtor corporation or its duly authorized withholding agent 270 shall forward all certificates to the collector of internal revenue with its duplicate monthly list return, Form 1012, revised, and such collector shall forward the original return and the certificates to the commissioner, as heretofore.

Art. 44. Until January 1, 1918, withholding was required under 271 the act of September 8, 1916, as amended, at the rate of 2 per cent. On and after January 1, 1918, withholding provisions of the law as to citizens and resident aliens (sec. 9-c, act Sept. 8, 1916, as amended) will extend to the normal tax imposed by section 1, act October 3, 1917. Thereafter the exemption which may be claimed by citizens and resident aliens from withholding will be such as will be allowable under section 3, act October 3, 1917.

Art. 45. Withholding will at all times be limited to 2 per cent, 272 except in case of interest on corporate bonds owned by foreign corporations having no office or place of business in the United States, in which case deduction will be at the rate of 6 per cent.

Art. 46. Return is to be made for the tax withheld in manner and 273 on a form to be prescribed by the Commisisoner of Internal Revenue, with the approval of the Secretary of the Treasury. This return is to be made after February 1 and on or before March 1 annually. The return shall show the name and address of the withholding agent, character of income, and the name and address of the recipient or his agent, amount of income, exemption claimed, and the amount of tax at 2 per cent withheld thereon.

Art. 47. Any income withheld from a citizen or resident alien in 274 1917 prior to October 3, 1917, except in the case covered by section 9 (c) (from interest paid on securities having a tax-free covenant clause) of the act of September 8, 1916, as amended, shall be released by the withholding agent and paid over to the individual from whom it was withheld or his proper legal representative.

- 275 The income upon which such tax was so deducted and released shall be included in the return, if any, of such individual for the purpose of assessment and collection of the income tax.

LICENSE.

- 276 Art. 48. All persons, corporations, partnerships, or associations undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner of Internal Revenue, and shall be subject to such regulations enabling the Government to obtain the information required under this title as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and whoever knowingly undertakes to collect such payments as aforesaid without having obtained a license therefor or without complying with such regulations, shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding \$5,000 or imprisoned for a term not exceeding one year, or both, in the discretion of the court. Such licensee shall write or stamp on the face of the item: "Information obtained and furnished by _____ (name of collecting agent)."

INTENT OF THE LAW.

- 277 Art. 49. The intent and purpose of the income-tax law is that all gains, profits, and income of a taxable class shall be charged and assessed with the corresponding income tax, normal and additional, and such tax shall be paid by the owner of such income or the proper representative thereof having the receipt, custody, control, or disposal of the same. In any case where the conditions which obtain do not appear to fall within the law and regulations for the assessment and collection of the income tax, the proper tax shall be assessed in the particular case by the Commissioner of Internal Revenue upon his findings concerning the same. Ownership of income and liability for tax thereon shall be determined as of the year for which the return is required to be rendered.

RECORD TO BE KEPT.

- 278 Art. 50. Every individual, partnership, corporation, or association liable to any tax imposed under the internal revenue laws of the United States or for the collection thereof shall keep such records and render such statements and returns, under oath, as shall be prescribed by the Commissioner of Internal Revenue.

PENALTIES.

Art. 51. For failure to make payment of tax before close of business 279
 June 15 and 10 days after notice and demand.—There shall be added to
 the tax 5 per cent on the amount of tax unpaid and interest at the
 rate of 1 per cent per month from the time the same became due,
 except from the estates of insane, deceased, or insolvent persons.
 (Sec. 9 (a).)

And the delinquent shall also be liable for specific penalty of not 280
 less than \$20 nor more than \$1,000. (Sec. 18.)

Art. 52. For failure to make return within time fixed by law for tax 281
 or information purposes.—Penalties are:

Ad valorem.—Fifty per cent on the amount of tax shown by a cor- 282
 rect return. (Sec. 16, 3176, R. S.)

Specific.—Not less than \$20 nor more than \$1,000. (Sec. 18.) 283

Liability of individuals to— 284

Specific penalties provided by the income-tax law are held to
 attach to the person and in case of death of such person are non-
 enforceable.

Ad valorem penalties (those measured by income) attach to income 285
 and are to be enforced regardless of the death of the owner of the
 income by which the penalty is measured.

Waiver after expiration of time limit for assessment.—Where the 286
 limitation of the statute as to assessment has run and a written
 waiver of exemption from assessment is given by the taxpayer, the
ad valorem penalties of 50 per cent, addition to tax, is not to be
 assessed for delinquency in filing return.

Return made and mailed in time.—If a return is made and placed 287
 in the United States mail, properly addressed, and postage paid, in
 ample time, in due course of mail, to reach the office of the collector
 or deputy collector on or before the last due date, no penalty will be
 held to attach should the return not be actually received by such
 officer until subsequent to that date.

Art. 53. For false or fraudulent return, or statement, willfully made 288
 with intent to defeat or evade assessment of tax.—Penalties are:

Ad valorem.—One hundred per cent to be added to the amount of 289
 the tax shown by a correct return. (Sec. 16, 3176, R. S.)

Specific.—Fine as for misdemeanor, not exceeding \$2,000 or im- 290
 prisonment not exceeding one year or both, in the discretion of the
 court, with the costs of prosecution. (Sec. 18.)

REASONABLE CAUSE.

Art. 54. Section 3176, Revised Statutes, as amended by act of 291
 September 8, 1916, provides that if after delinquency has ensued and
 before receiving a *notice* from the collector of internal revenue, of
 such delinquency and request for a return, the delinquent individual

or corporation shall have filed with the collector of internal revenue a return and shall accompany such return with a showing "that failure to file it (in time) was due to a reasonable cause and no willful neglect. no such addition shall be made to the tax."

- 292 "Reasonable cause," for the purpose of this article of the regulations, is held to be such a condition of fact as had the taxpayer default exercised ordinary business care and prudence it would have been impracticable or impossible for him to have filed return on prescribed time.

NOTICE.

- 293 **What constitutes.**—The "notice from the collector" provided in subsection 3176 of section 16 of the act of September 8, 1916 the "note or memorandum addressed to such person requiring him or her to render to such collector or deputy collector the list or return required by law within 10 days from the date of such note or memorandum, verified by oath or affirmation," prescribed by subsection 3173 of said section 16 of the act of September 8, 1916.
- 294 Delinquent returns must be accompanied by an affirmative showing of fact alleged as reasonable cause for excuse from 50 per cent penalty. The Commissioner of Internal Revenue will pass upon validity of the showing. The showing must be in the form of affidavit, under oath, and should be attached to the return. A penalty of 50 per cent "addition to tax" will be asserted in all cases where the showing made is not approved by the Commissioner Internal Revenue.
- 295 The specific penalty, subject to the authority of the Commissioner of Internal Revenue to entertain offers in compromise, is fixed not less than \$20 nor more than \$1,000, and is asserted for refusal to pay tax, neglect to pay tax, to make a return, or supply information required under the income-tax law and at the time required, and is to be asserted independently of the penalty by way of "addition to tax."
- 296 The limitation of penalty for refusal or neglect by section 16 of the act of September 8, 1916, as amended, to \$1,000 is enlarged as to corporations by section 14 (c) of the act of September 8, 1916, which places the limitation of amount of penalty for delinquency or fraud of and by corporations at \$10,000, so that as to corporations the penalty for delinquency or fraud is not less than \$20 nor more than \$10,000, and each officer of the corporation required by law to make, render, sign, or verify any return who makes any false or fraudulent return or statement with intent to evade or defeat the assessment of tax, will, in addition to and apart from the corporation, be subject to prosecution, and on conviction to fine not exceeding \$2,000 imprisonment not exceeding one year, or both, in the discretion of the court, with the costs of prosecution.

PART II.

INCOME-TAX REGULATIONS RELATING TO CORPORATIONS.

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CORPORATIONS SUBJECT TO TAX.

- 297 **Art. 55. Domestic corporations tax under act of September 8, 1916.**—Under the provisions of Parts II and III of Title I of the act of September 8, 1916, as amended, every corporation, joint-stock company or association or insurance company organized in the United States, no matter how created or organized, except those specifically exempt under section 11 of this title, shall be subject to pay annually an income tax of 2 per cent upon the entire net income received during the preceding calendar or fiscal year, as the case may be.
- 298 **Art. 56. War income tax under act of October 3, 1917.**—Under Title I of the act of October 3, 1917, an additional tax of 4 per cent, known as the war income tax, is similarly imposed on the net income of such corporations, except that for the purpose of the assessment of the additional 4 per cent tax the net income of such corporations shall be credited with the amount of dividends received from other corporations subject to tax under Title I of the act of September 8, 1916, as amended, and the act of October 3, 1917.

DEFINITIONS.

- 299 **Art. 57. Corporations defined.**—"Corporation" or "corporations," as used in these regulations, shall be construed to include all corporations, joint-stock companies and associations, and all insurance companies coming within the terms of the law, as well as all business trusts organized or created for the purpose of engaging in commercial or industrial enterprises, the capital of which is evidenced by certificates or shares of interest issued or issuable to members on the basis of which profits are distributed or distributable. Such organizations will be hereinafter referred to as corporations.
- 300 **Art. 58. Joint-stock companies and associations defined.**—The term "joint-stock companies" or "associations" shall include associations,

common-law trusts, or organizations by whatever name known which carry on or do business in an organized capacity, whether created under and pursuant to State laws, trust agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the members or shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has, or has invested, in the business or property of the organization, all of which joint-stock companies or associations shall in their organized capacity be subject to the tax imposed by this act, and shall make returns of annual net income accordingly.

Art. 59. The terms "taxable year" or "taxable period" as and 301 when used in these regulations shall mean the calendar or duly established fiscal year or period for which the return is made or is required to be made.

The term "this title" when used in these regulations means Title I 302 of the act of September 8, 1916, as amended by the act of October 3, 1917.

Art. 60. Incomplete corporations.—Corporations which have applied 303 for but have never received charters and corporations which have received charters but never perfected their organizations and which as entities have transacted no business and had no income whatever from any source may, upon presentation of the facts to the collector, be relieved from the necessity of making returns, so long as they remain in this unorganized condition. In the absence of a showing to this effect to the collector of internal revenue, such companies will be required to make returns and will be liable to the penalties of the law for failure to do so.

Art. 61. Corporation dissolved prior to October 4, 1917.—A corpora- 304 tion which was dissolved in 1917, prior to passage of the war-revenue act of October 3, 1917, is subject to tax under the act of September 8, 1916, as amended, and also to the war income tax and the war excess profits tax imposed by the act of October 3, 1917 (*Brady et al. v. Anderson*, 240 Fed., 665). A corporation so situated will make a return on revised form 1031, covering the period in 1917 during which it was in business prior to its dissolution. If it shall have previously made a return covering this period and shall have paid any excess profits tax under the act of March 3, 1917, it shall be entitled to credit for the amount of such tax so paid against any excess profits tax assessable against it under Title II of the act of October 3, 1917.

Art. 62. Limited partnerships.—Limited partnerships—that is, part- 305 nerships having one or more special partners who may share in the profits of the firm but whose liability for the debts of the company

is limited to the amount of capital invested by such special partner or partners—are held to be associations within the meaning of this title, and as such are required to make returns of annual net income and pay any tax thereby shown to be due. The income received by the members out of the earnings of such limited partnerships will be treated in their personal returns in the same manner as if it were dividends on the stock of corporations and will be subject to the additional or surtaxes in the hands of the recipient.

- 303 **Art. 63. Common-law partnerships.**—Common-law partnerships are not associations within the meaning of income-tax law, and are therefore not required to make returns for the purpose of the income tax except as they may be requested by the Commissioner of Internal Revenue or by any district collector to make returns of their earnings, profits, and income.

FOREIGN CORPORATIONS.

- 307 **Art. 64. Taxable income.**—Under section 10 of Title I of the act of September 8, 1916, as amended, a tax of 2 per cent shall be levied assessed, collected, and paid annually upon the total net income received in the preceding calendar year, from all sources within the United States, by every corporation, joint-stock company or association or insurance company organized, authorized, or existing under the laws of any foreign country.
- 308 **Art. 65. War income tax.**—The additional tax of 4 per cent on net income imposed by the act of October 3, 1917, shall apply to foreign corporations in the same manner as in the case of domestic corporations, except that it shall apply only to income received from sources within the United States.
- 309 **Art. 66. Source within United States.**—It is not necessary that the foreign corporation shall be engaged in business in this country or that it have an office, branch, or agency in the United States. Liability to the tax attaches with respect to the income, the source of which is in the United States.
- 310 “Source” as here used means the place of the origin of the income.
- 311 Every foreign corporation having income from sources within the United States must make returns of annual net income in accordance with the rule set out in section 12 (b) of the act of September 8, 1916, as amended by the act of October 3, 1917.

CORPORATIONS EXEMPT FROM TAX.

- 312 **Art. 67. Conditional.**—Corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, business leagues, chambers of commerce, boards of trade, civic leagues, cemetery companies, and pleasure and recreation

clubs, are not, as such, exempt from the requirements of this title. Their exemption is conditional, and in order to be relieved from liability under the law they must file with the collector of internal revenue an affidavit setting out the character and purpose of the organizations, and showing that no part of any income which they receive inures to the benefit of any private stockholder or individual, and that such income is used exclusively for the promotion of the purposes for which organized as indicated in the particular paragraphs under which exemption is claimed.

Art. 68. Unconditional.—Among the corporations exempt from the 313 tax, without condition, are labor, agricultural and horticultural organizations, mutual savings bank not having capital stock represented by shares, fraternal beneficiary society, order, or association operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, domestic building and loan associations, Federal land banks, and national farm loan associations, organized pursuant to the act of July 17, 1916, joint-stock land banks as to income specified in the law, and public utilities whose income inures to the benefit of any State, Territory, or political subdivision thereof.

In all cases wherein the exemption is without condition, and the 314 collector is satisfied that the organization comes within the exempted class, he will be authorized to eliminate it from his list and relieve it from the necessity of making returns.

Corporations exempt under the act of September 8, 1916, are also 315 exempt from the war income tax imposed by Title I of the act of October 3, 1917.

Art. 69. Mutual insurance companies, etc.—The organizations men- 316 tioned in paragraph "tenth" of section 11, act of September 8, 1916, as amended, are specifically exempt, provided that their entire income consists *solely* of assessments, dues, and fees collected from members for the *sole* purpose of meeting expenses, incurred in pursuance of the purpose for which organized. If any of such organizations have income from any source other than assessments, dues, and fees, such income will be held to be subject to tax, and the organizations receiving the same will be required to make returns and to pay any tax thereby shown to be due. (T. D. 1933, 2152, 2161.)

Art. 70. Domestic building and loan associations.—A domestic build- 317 ing and loan association entitled to exemption is one organized under and pursuant to the laws of the United States or under and pursuant to the laws of some State or Territory thereof, and which is actually carrying on for the benefit of its members a building and loan association business in accordance with the laws under which it is organized. The fact that such an association issues fully paid or prepaid shares, calling for a specified rate of interest or dividends,

will not disqualify it for exemption. The exemption is without qualification other than that the association is a domestic building and loan association. If a corporation by any other name is carrying on an exclusive building-and-loan business, before it is entitled to exemption it will be incumbent upon it to show to the satisfaction of the commissioner of internal revenue that it is in fact a building and loan association.

- 318 Art. 71. Cemetery company.**—A cemetery company having a capital stock represented by shares, or which is operated for profit or for the benefit of others than its members, does not come within the exempted class, and will be required to make returns of annual net income and pay any income tax thereby shown to be due.
- 319** In the case of such company a reserve set aside out of profits as a "maintenance fund" is not deductible from gross income, and any accretions to such fund will be held to be income and, as such, must be returned by the corporation. The expenses of maintenance will be deductible as they are paid.
- 320 Art. 72. Social clubs.**—Social clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes are exempt from the tax, provided no part of any net income which they receive inures to the benefit of any private stockholder or individual. This exemption will reach practically all social and recreation clubs which are supported by membership fees, dues, and assessments.
- 321** If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture, or horticulture, in the sale of real estate, timber, etc., for profit, it will be held that such club is not organized and operated exclusively for pleasure, recreation, or social purposes. It thus becomes a business or commercial enterprise, and any profit realized from such activities is subject to the tax imposed by this title, and the club so operated must make returns of annual net income.
- 322 Art. 73. Labor, agricultural and horticultural organizations.**—Agricultural or horticultural organizations, which are exempt under this title, do not include those corporations engaged in growing agricultural or horticultural products, raising live stock or similar products for profit, but will include only those organizations which, having no net income inuring to the benefit of their members, are educational or instructive in character, and which have for their purpose the betterment of the conditions of those engaged in these pursuits, the improvement of the grade of their products, and the encouragement and promotion of those industries to a higher degree of efficiency. (T. D. 2090.)
- 323** Included in this class as exempt are those organizations such as county fairs and like associations of a quasi-public character, which,

through a system of awards, prizes, or premiums, are designed to encourage the production of better live stock, better agricultural and horticultural products, and whose income, derived from gate receipts, entry fees, donations, etc., is used exclusively to meet the necessary expenses of upkeep and operation.

Societies or associations which have for their purpose the holding of annual or periodical race meets, and from which profits inure or may inure to the benefit of the members or stockholders do not come within the terms of this exemption. 324

Art. 74. Societies not agricultural or horticultural.—A corporation engaged in the business of raising stock or poultry, or growing grain, fruits, or other products of this character, as a means of livelihood and for the purpose of gain, is an agricultural or horticultural society only in the sense that its name indicates the kind of business in which it is engaged and, as such, is not exempt from the requirements of the law, and must make returns and pay any income tax thereby shown to be due. (T. D. 2090.) 325

Art. 75. Cooperative associations defined.—Cooperative associations, in order to come within the exemption provided in paragraph "eleventh" must establish to the satisfaction of the collector or Commissioner of Internal Revenue the fact that, for their own account, they have no net income, their business being to market the products of their members, and that the entire proceeds of such marketing, less necessary selling expenses, are turned back or paid to the members on the basis of the quantity of produce furnished by them—quality and grade being considered—as the purchase price of such produce. 326

If in the course of their business such associations purchase for cash at a stipulated price articles of produce with a view to selling them for gain, it will be held that such associations are organized for profit and such associations will be required to make returns of annual net income and include therein, for the purpose of the tax, all income derived from such transactions. (T. D. 2090.) If amounts paid to members are based solely upon the quantity of produce furnished, such amounts may be deducted from the gross proceeds of sales, and the taxable net income will be the amount of earnings passed to surplus, or distributed or distributable among members on the basis of their stock holdings. 327

Art. 76. Cooperative dairy defined.—Cooperative dairy companies or associations not having capital stock and engaged in collecting milk and disposing of the same or the products thereof, and distributing the proceeds of the business, less necessary operating expenses, among their patrons, upon the basis of the quantity of butter fat in the milk furnished by such patrons, are held to be exempt from the tax imposed by this title. 328

- 329 If, however, a dairy company purchases milk at a stipulated price and disposes of the same, or its products, through sale or otherwise, at a profit, and such profit inures to the benefit of the company or its members, on any basis other than the butter-fat content of milk furnished, such company will come within the requirements of the law, and will be subject to the tax. (T. D. 1996.)
- 330 **Art. 77. Lodge system defined.**—A society or association “operating under the lodge system” is one organized under a charter or dispensation with properly appointed or elected officers, with an adopted ritual or ceremonial, holding meetings at stated intervals. An order, society, or association coming within this definition is exempt from the requirements of the income-tax law.
- 331 **Art. 78. Qualifications for exemption.**—In every instance wherein exemption is conditioned upon the ground that no part of the net income received by corporations inures to the benefit of any private stockholder or individual, it will be necessary, before such organizations will be classed as exempt, for them to show to the satisfaction of the collector or the Commissioner of Internal Revenue:
- (1) The character and purpose of the organization;
 - (2) The source from which all its income is derived;
 - (3) What disposition is made of such incomes; and
 - (4) Whether or not any of it is credited to surplus or inures or may inure to the benefit of any private stockholder or individual.
- 332 **Art. 79. Organizations, exemption doubtful.**—Any corporation which entertains any doubt as to its status under the law, for the reason that it does not clearly come within one or another of the classes of those specifically enumerated as exempt, should, within the prescribed time, file a return and attach thereto for the consideration of the collector, a statement setting out fully the nature and purpose of the organization, the source of its income, what disposition is made of it, and particularly of any surplus which it may receive over and above its reasonable needs.
- 333 If the collector is in doubt, he will refer the statement and return to the Commissioner of Internal Revenue for decision, and withhold listing for assessment until a decision is reached. (T. D. 2090.)
- 334 **Art. 80. Exemption established.**—When a corporation or organization has established its right to exemption under any of the paragraphs of section 11 of this title, it will be unnecessary for it to make a return or to make any further showing thereafter with respect to its status under the law, unless it changes the character of its organization or the purpose for which it was originally created.
- 335 Collectors will keep a list of all corporations whose exemption is conditional, to the end that they may occasionally inquire into their status and ascertain whether or not they are violating the conditions upon which their exemption is predicated.

Art. 81. Exempt corporations required to withhold.—While the or- 336
ganizations enumerated in section 11 of this title are themselves
exempt from the tax on any income received by them, they are not
exempt from the requirements of the title with respect to the with-
holding of the normal tax on bond interest or dividends paid to
foreign corporations or bond interest paid to individuals on bonds
having a tax free covenant or from furnishing information in ac-
cordance with the provisions of this title, as amended by section
1205 of Title XII of the act of October 3, 1917. (T. D. 2407.)

Art. 82. Rate of taxation, fiscal year ended during 1916.—The rate 337
imposed by Title I of the act of September 8, 1916, 2 per cent, shall
apply to the total net income received by every taxable corporation,
joint-stock company or association, or insurance company, in the
calendar year 1916 and in each year thereafter, except that if it has
fixed its own fiscal year under the provisions of the existing law, the
foregoing rate shall apply to the proportion of the total net income
returned for the fiscal year ending prior to December 31, 1916, which
the period between January 1, 1916, and the end of such fiscal year
bears to the whole of such fiscal year. The rate of 1 per cent shall
apply to the remaining portion of the total net income returned for
such fiscal year.

Prorated for fiscal year.—For the purpose of the 4 per cent addi- 338
tional tax imposed by the act of October 3, 1917, it is provided that
in the case of a corporation making its return on the basis of its own
fiscal year (other than the calendar year) this tax, for a fiscal year
ending during the calendar year 1917, shall be levied only on that
proportion of its net income (less dividends received) which the
period from January 1, 1917, to the end of the fiscal year bears to the
entire fiscal year. *

If the last previous return was made for the period ended Decem- 339
ber 31, 1916, and a return is made for a fiscal period ended with the
last day of some month in 1917, the tax will be computed on the entire
net income so returned. Also in the case of a new corporation mak-
ing a return for the period from the date of its organization to the
close of the calendar year, the tax will be computed on the entire net
income so returned.

INCOME EXEMPT FROM TAX.

Art. 83. Obligations of State.—Among the incomes exempt from the 340
provisions of this title is that derived from interest upon the obliga-
tions of a State or any political subdivision thereof.

A political subdivision as here used is held to mean a district, di- 341
vision, or community created by proper State authority and which,
by virtue of such authority is vested with power to exercise certain

governmental functions, such as prescribing regulations for its government, the exercise of certain police powers, the assessment and collection of taxes, etc.

- 342 Art. 84. Political subdivision.**—Obligations issued by the duly constituted authorities of such a community so organized and empowered are the obligations of a political subdivision of the State and interest received on obligations of this character is exempt from the taxes imposed by the acts of September 8, 1916, and October 3, 1917. However, a district without power to exercise any governmental function, created for the purpose of making some improvement, primarily beneficial to the property located in and comprising the district, is not, within the meaning of these acts, a political subdivision of the State. Obligations issued in payment for such improvement, although guaranteed by a county, municipality, or other political subdivision of the State, are not the obligations of the State or of any political subdivision thereof; but are rather the obligations of the benefited property upon which they constitute a lien. Hence, the income derived from obligations, which are a direct charge against or lien upon benefited property, is not exempt from these taxes, and must be returned as income of the recipient. (T. D. 1946.)
- 343 Art. 85. Obligations of the United States.**—Section 1200 of the act of October 3, 1917, so amends section 4 of the act of September 8, 1916, as to exempt from the tax, interest on the obligations of the United States issued after September 1, 1917, only if and to the extent provided in the act authorizing their issue.
- 344 United States bonds and certificates issued under the act of September 24, 1917.**—Said act provides that bonds and certificates issued thereunder shall be exempt from all taxes except estate or inheritance taxes, additional income taxes, commonly known as surtaxes, and excess or war profits taxes. Under this act the income from such bonds is exempt from the war income tax of 4 per cent imposed upon the net income of corporations by section 4 of Title I of the act of October 3, 1917, and the 2 per cent tax imposed by section 10 of Title I of the act of September 8, 1916, as amended.
- 345 Art. 86. Dividends, Federal reserve bank.**—The Federal reserve statute, section 3, of the act of October 22, 1914, provides that Federal reserve banks and the capital stock and surplus therein, are exempt from taxation.
- 346** Under this provision of law the exemption provided for in the Federal reserve act attaches to and follows the income derived from dividends on stock of Federal reserve banks into the hands of stockholders, that is to say, the dividends received on the stock of Federal reserve banks are exempt from the taxes imposed by the acts of September 8, 1916, as amended, and of October 3, 1917.

This ruling does not contemplate, however, that dividends paid **347** by member banks are exempt from the 2 per cent tax imposed by this title, but such dividends, in so far as they may be received by other corporations, may be treated as a credit against net income in computing the war income tax imposed by Title I of the act of October 3, 1917.

Art. 87. Foreign Governments.—Section 30 of the act of September **348** 8, 1916, as amended by the act of October 3, 1917, provides that the income of foreign Governments received from investments in the United States in stocks, bonds, or other domestic securities owned by them, or from interest on deposits in banks in the United States of money belonging to such foreign Governments, is exempt from the tax imposed by this title. This does not, however, exempt from the tax any income collected by foreign Governments from investments in the United States in stocks, bonds, or other domestic securities, which are not bona fide owned by but are loaned to such foreign Governments. The exemption here provided for is predicated upon the fact that the securities or moneys from which income is derived are actually owned by such foreign Governments.

GROSS INCOME.

Art. 88. Gross income defined.—Gross income embraces not only the **349** operating revenues but also income, gains, or profits from all other sources, such as rentals, royalties, interest, and dividends from stock owned in other corporations; and also profits made in other corporations; and also profits made from the sale of assets, investments, etc. A true and accurate record of all income received, as well as of all disbursements or charges against income, should be kept, in order that it may be identified and verified by an internal-revenue officer if an examination of the books should be deemed advisable.

Art. 89. Interest on bonds and dividends.—Gross income from sources **350** within the United States as applied to foreign corporations shall include interest received on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, as well as income derived from dividends on capital stock or from the net earnings of resident corporations, joint-stock companies, or associations, or insurance companies, subject to tax under this title, and likewise income from rentals and royalties, from business transacted or capital invested in the United States.

Art. 90. Banks and financial institutions.—Gross income of banks and **351** other financial institutions consists of the total revenue received within the year for which the return is made from the operation of the business, including income, gains, or profits from the sale of capital assets and from all other sources.

- 52 In cases where securities or other assets, real, personal, or mixed, acquired prior to March 1, 1913, are disposed of during the year, the gain or loss thereon will be based upon the difference between the price at which disposed of and the fair market price or value of such assets as of March 1, 1913, or the difference between the price at which disposed of and the *cost* if acquired subsequent to that date.
- 53 **Art. 91. Manufacturing corporations.**—Gross income for the purpose of returns of manufacturing companies shall consist of the total sales plus the inventory at the end of the year less the sum of the cost of goods or materials purchased during the year and the inventory at the beginning of the year. Instructions as to how inventories shall be taken will be included in special regulations to be furnished upon application to the collector of internal revenue. To the gross manufacturing income should be added the income, including dividends, received from other corporations, and gains or profits from all sources.
- 54 **Art. 92. Mercantile corporations.**—For the purpose of returns gross income of mercantile companies shall consist of the total sales plus the inventory at the end of the year less the sum of the cost of goods purchased during the year and the inventory at the beginning of the year. As to method of taking inventory, see preceding paragraph. To the amount of income thus ascertained should be added the income, gains, or profits derived from all other sources.
- 55 All sales made during the year, whether compensated for by accounts receivable, bills receivable, cash, or other property at a determined cash value, must be included in gross income of the year in which the sales were made.
- 56 **Art. 93. Miscellaneous corporations.**—Gross income of miscellaneous corporations consists of total revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income, including the income, gains, or profits from all other sources, including dividends received.
- 57 **Art. 94. Income from damages recovered.**—When a corporation as a result of suit or otherwise secures payment for damages which it may have sustained, and the amount of such payment is in excess of an amount necessary to make good the damage or damaged property, the amount of such excess shall be considered and returned as income for the year in which received. If the entire or an estimated amount of the damage shall have been previously charged off and deducted from gross income, then the amount recovered shall be returned as income.

If the amount recovered is less than the damage sustained or less than an amount necessary to make good the damage, the difference between the actual amount of damage sustained and the amount recovered will be deductible as a loss.

Art. 95. Proceeds of sale of rights income.—In cases wherein corporations desiring to secure additional capital propose to issue and sell further shares of stock, reserving to their stockholders the right to subscribe for, at par or any other stipulated price, a certain number of shares of the new stock issue, proportioned to the number previously held, and if such stockholders shall sell their rights, it will be held that the proceeds of such sale are in their entirety income for the year in which the rights are sold, and should be so returned by the stockholders, whether they be individuals or corporations. 358 359

Art. 96. Voluntary payments by stockholders.—In cases wherein a corporation requires additional funds for conducting its business and obtains such needed money through voluntary pro rata payments by its stockholders, and such amounts received are credited to its surplus account or to a special capital account, the amounts so received will not be considered income, although, as representing this additional fund, there is no increase in outstanding shares of stock or liability of the corporation. The payments under such circumstances are in the nature of voluntary assessments upon, and represent an additional price paid for, the shares of stock held by the individual stockholders, and will be treated as an addition to and as a part of the operating capital of the company. 360

Art. 97. Sale of capital stock.—The proceeds from the sale by a corporation of its shares of capital stock, whether such proceeds be in excess of or less than the par value of the stock subscribed for and issued, constitute the capital of the company.

If the stock is sold at a premium, the premium is not income. 361 Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from operating income.

Art. 98. Treasury stock—When taxable.—Treasury stock, wherever and whenever that term is used in connection with the accounts of the corporation or for income-tax purposes, will be held to mean stock which had been previously issued by the corporation and which had been repossessed by it through purchase or otherwise and then carried on its books as an asset. If such stock is resold at a price in excess of its cost upon repossession, such excess shall be returned as income for the year in which resold. Unissued stock, which had been retained by the corporation for the purpose of future sale, will not, for the purpose of the income tax, be considered "Treasury stock," and when sold no part of the proceeds of such sale will be considered taxable income. Nor will there be any deductible loss if such stock is sold at a price less than par. 362 363

- 364 Art. 99. Donations to corporations of capital stock.**—If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the stockholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, the sale of such stock will be considered a capital transaction, and the proceeds of such sale will be treated as capital and will not constitute income to the corporation.
- 365 Art. 100. Interest on United States bonds and certificates.**—The interest received on all United States bonds and certificates exempt from normal income tax, need not be included in the gross income in the return made for the purpose of the income tax (2 per cent) or the war income tax (4 per cent), but interest on bonds and certificates issued under the act of September 24, 1917, in excess of the interest on \$5,000 aggregate principal amount of such bonds and certificates must be included in the net income upon which the war excess-profits tax is computed.
- 366 Art. 101. Income from sale of capital assets.**—If a corporation sells its capital assets in whole or in part, it will include in its gross income for the year in which the sale was made an amount equivalent to the excess of the sales price over the fair market price or value of such assets, as of March 1, 1913, if acquired prior to that date, or over cost if acquired subsequent to that date.
- 367** If the purchase price is paid with stock issued by a purchasing company, the purchase price will be the actual value at the time of the stock issued in payment for such assets.
- 368 Art. 102. Leased properties.**—When a corporation shall have leased its property in consideration that the lessee shall pay in lieu of rental an amount equivalent to a certain rate of dividend on its capital stock or the interest on its outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee direct to the stockholders and bondholders of the lessor. The lessee, in making these payments direct to the bondholders and the stockholders, does so as the agent of the lessor, and the latter is none the less liable to return the amounts thus paid as income and to pay any tax that may be due thereon. (T. D. 2620).
- 369** The fact that a corporation has conveyed or let its property and has thus parted with its management and control or has ceased to engage in the business for which it was originally organized will not relieve it from liability to income tax. If it has or may have income directly or indirectly from any source, it must make a return, account for all such income, and pay any tax assessable upon such income.

Art. 103. Income to bondholders and stockholders.—While the payments made by the lessee direct to the bondholders or stockholders are rentals to both it and the lessor, rentals paid in one case and rentals received in the other, to the bondholders and the stockholders they are interest and dividend payments received as from the lessor, and as such will be accounted for in their returns of annual net income.

Art. 104. Stock trust certificates.—Stock trust certificates or leased line certificates, as the case may be, issued by the lessee for the purpose of securing or holding control of the stock of the lessor are held to be issued in lieu of the certificates of capital stock, and for the purpose of this tax will be treated as capital stock and the amounts received by the holders of these certificates are dividends to the holders, to be treated as rentals by both lessee and lessor and constitute an allowable deduction in the one case and an item of income in the other, accordingly as they are paid and received.

Art. 105. Dividends—When taxable.—Section 10 of this title specifically sets out that corporations shall return as gross income all income received from all sources during the year for which the return is made. Among the items to be included in income are dividends on stock and interest on bonds or other interest-bearing obligations received from other corporations. Such dividends are, however, not subject to the war income tax of 4 per cent.

Art. 106. Dividend defined.—The term “dividends” shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company or association, or insurance company, out of its earnings or profits accrued since March 1, 1913, and payable to its shareholders whether in cash or in stock of the corporation, joint-stock company or association, or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

Art. 107. Any distribution made to shareholders in the year 1917 or subsequent years (except any distribution of dividends made prior to Aug. 6, 1917, out of earnings or profits accrued prior to Mar. 1, 1913) shall be deemed to have been made from the most recently accumulated undivided surplus or profits, and shall constitute income of the distributee for the year in which received, and shall be taxed to such distributee at the rates prescribed by law for the years in which such surplus or profits were earned by the distributing corporation.

Thus, if a corporation distributed dividends in 1917, such dividends will be deemed to have been paid from the earnings of 1917, and the recipient, if an individual, will be liable to additional tax, if any, and if a corporation, to income tax, at the rates for the year

1917, unless it is shown to the satisfaction of the Commissioner of Internal Revenue that at the time such dividends were paid, the earnings up to that time were not sufficient to cover the distribution, in which case the excess over the earnings of the taxable year will be deemed to have been paid from the most recently accumulated surplus of prior years, and will be taxed at the rate or rates for the year or years in which earned.

376 A corporation declaring and paying dividends out of a surplus or earnings accumulated over a period of years, should make a record in its books of the amount of dividends paid out of each year's undistributed surplus or profits, and advise the stockholders accordingly, in order that the dividends received by them may be taxed at the respective rates prevailing during the years in which the surplus or profits so distributed were earned.

377 The provisions of section 31, subdivision (b) do not apply to distributions made prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913; that is to say, that such distributions will *not* be deemed to have been made out of the most recently accumulated surplus or profits, if at the time of distribution, before August 6, 1917, they were specifically declared to be out of accumulations prior to March 1, 1913.

378 **Art. 108. Warrants of city, etc.**—In cases wherein warrants are issued by a city, town, or other political subdivision of a State, and are accepted by the contractor in payment for public work done, the face value of such warrants must be returned as income for the year in which they are received. If, for any reason, the contractor upon conversion of the warrants into cash, does not receive and can not recover the full face value of the warrants so returned, he may allowably deduct from gross income for the year in which the warrants are converted into cash, any loss sustained, which loss will be measured by the difference between the face value of the warrants returned as income and the amount actually received for them in cash, or its equivalent, when redeemed or disposed of.

379 **Art. 109. Sale of patents.**—A corporation disposing of patents by sale, should determine the profit or loss arising therefrom, by computing the difference between the selling price and the cost, or value as of March 1, 1913, if acquired before that date. The apparent profit or loss should be increased or decreased, as the case may be, by the amounts deducted since March 1, 1913, as a return of capital invested in such patents.

380 **Art. 110. Bad debts recovered.**—Bad debts or accounts charged off by a corporation because of the fact that they were determined to be worthless, and subsequently recovered, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. Neither the date at which the debt was charged off

nor the fact that it was or was not deducted from gross income in any return made for tax purposes, will in any way affect its character as income of the year in which recovered.

Art. 111. Exchange of property for stock.—In cases wherein property 381 was taken over in exchange for the capital stock of a corporation at a par value in excess of the fair market value of the property, and such property should be later sold, it will be necessary to ascertain as nearly as possible the fair market value of the property at the time it was taken over or as of March 1, 1913, if acquired before that date, and any excess over this ascertained fair market value at which the property is sold will be held to be profit or income to the corporation for the year in which the sale was made.

Art. 112. Excess value.—Similar action may be taken in cases 382 wherein corporations acquire property prior to March 1, 1913, for a mere nominal sum and which had, as of March 1, 1913, a value greatly in excess of such nominal sum. A careful estimate of the fair market value of such property as of March 1, 1913, may be made and set up as the capital invested in the property, and if such property is thereafter disposed of at a price in excess of such fair market value, the amount so in excess will be treated as income to be accounted for in preparing the return of annual net income of the year in which the property is sold. The value of the property fixed in the manner and for the purpose hereinbefore indicated will be subject to the approval of the Commissioner of Internal Revenue.

If the property was acquired subsequent to March 1, 1913, the 383 amount for which it is later sold or disposed of in excess of the cost price, regardless of the fact that it may have been acquired for a mere nominal price, will constitute income for the year in which the property was disposed of and must be so returned.

Art. 113. Royalties from patent rights.—Royalties received by a cor- 384 poration in accordance with a contract by which it has assigned the patent rights to manufacture machines, etc., are income and should be so accounted for. The owner of the patent may deduct from gross income each year, until the capital invested therein is extinguished, a sum ascertained by dividing the cost of the patent by the number of years constituting its life or by a number representing the years of its life remaining after the date of acquirement.

Art. 114. Bank discounts.—In cases wherein banks or other cor- 385 porations loan money by discounting bills or notes, one of two methods shall be used in determining the amount of discount that is to be reported as income, namely (1) if the bank or corporation makes a practice of crediting such discount directly to a "discount account" or to profit and loss, the total amount thus credited during the year shall be considered income and shall be so reported, regardless of the fact that a portion of this amount may represent discount paid in

advance and not then earned; (2) if the bank or corporation follows the practice of crediting such discount to an "unearned discount account," and later, as the discount becomes earned, debits the unearned account and credits an "earned discount account" with the amount so earned, the total amount credited to the "earned discount account" during the year shall be considered income and shall be so returned. The corporation having income of this character should state in a memorandum attached to its return which of the two methods was used in determining the amount of discount returned as income.

- 386 Art. 115. Earnings of subsidiary company.**—In a case wherein a holding company actually takes up each month on its books and credits surplus or profit and loss with its proportionate share of the earnings of the underlying companies, such holding company will be required to include in its gross income the amounts thus taken up, regardless of the fact that the same may not have been actually paid to or received by it in cash. The fact that the underlying companies credit the holding company with the amount of earnings to which it is entitled on the basis of the stock it holds, together with the fact that the holding company takes up on its books the amount thus credited, renders it incumbent upon the holding company to return these amounts as income.
- 387 Art. 116. Sale of capital assets.**—Section 10 of this title provides that for the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired prior to March 1, 1913, the fair market price or value of such property, as of that date, shall be the basis for determining the amount of such gain derived.
- 388** This provision contemplates that all such gain realized and so ascertained, in cash or its equivalent, upon the sale or disposition of capital assets, shall be returned as gross income. In the case of property acquired subsequent to March 1, 1913, and later sold or disposed of, the difference between the cost and the selling price will be returned as income for the year in which the sale is made.
- 389 Sales on installment plan.**—In cases wherein the property is sold on the installment plan, title passing at the time of sale, the gain to be returned as income for the year in which the sale was made will be the excess of the contract price over the fair market price or value as of March 1, 1913, if the property was acquired prior to that date, or of the contract price over the cost, if acquired subsequent to March 1, 1913. If the buyer forfeits his contract and fails to meet any of the payments contracted to be made, the selling corporation may deduct from its gross income as a loss, such proportion of the defaulted payments as was previously returned as gross income. (T. D. 2137.)

Art. 117. Contract to sell.—In the case of a contract to sell real estate or other property on the installment plan, title remaining in the vendor until the property is fully paid for, the income to be returned by the vendor will be that proportion of each installment payment which the gross profit to be realized when the property is paid for bears to the gross contract price. If, for any reason, the vendee defaults in his installment payments and the vendor repossesses the property, the entire amount received on installment payments, less the proportion of profit previously returned, will be income to the vendor, and will be so returned for the year in which the property was repossessed. 390

In the case of real estate corporations, which purchase, or shall have purchased, a tract of land with a view to dividing it into lots or parcels of ground to be sold as such, the entire value, as of March 1, 1913, or cost, if acquired subsequent to that date, shall be equitably apportioned to the several lots or parcels, to the end that any gain derived from the sale of any such lots or parcels may be returned as income for the year in which the sale was made. 391

Real estate subdivisions.—This rule contemplates that there will be a measure of gain or loss in every lot or parcel sold, and does not contemplate that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain will be accounted for accordingly. If a loss results from the sale of capital assets, the amount of the loss to be deducted will be ascertained in a like manner as if a gain had been realized, and will be the amount by which the selling price is less than the value, as of March 1, 1913, or less than the cost, if acquired subsequent to that date, as the case may be. (T. D. 2077, 2137.) 392

Art. 118. Sale to other corporation.—In determining the profits realized or the loss sustained upon the sale of capital assets by one corporation to another, payment therefor being made in the stocks or bonds of the purchasing corporation, the profit or loss, as the case may be, from such sale will be ascertained upon the basis of the difference between the cost of such assets to the seller, in case they were acquired subsequent to March 1, 1913, or the fair market value as of March 1, 1913, if acquired prior to that date, and the fair cash value of the stock or bonds at the time the sale was made. (T. D. 2077, 2137.) 393

Art. 119. Sale by subsidiary to parent corporation.—Where a subsidiary or other corporation sells or transfers its assets to a parent or other corporation, accepting in exchange therefor the stock or bonds of the purchasing corporation, the question of gain or loss resulting from this transaction will be determined upon the basis of 394

the difference between the cost or market value as above indicated of the assets sold and the actual value of the stock or bonds given in exchange therefor. Any gain or loss thus ascertained as resulting from such a transaction will be added to or deducted from the entire gross income, as the case may be, of the selling corporation in the year in which the capital assets were sold. (T. D. 2077, 2137.)

395 Art. 120. Sale of merchandise on installments.—Corporations selling furniture, musical instruments, clothing, furnishing, etc., on the installment basis, title passing to the vendee at the time of sale, will treat such contracts as accounts receivable and as “sales during the year” at their face value, thus accounting for as income the difference between the cost and the sales price. If the purchaser defaults in payment and the account becomes uncollectible and the uncollected balance is charged off, the amount so charged off may be deducted as a loss.

396 In all cases where inventories are taken (and they must be taken where the business consists of buying and selling commercial commodities) for the purpose of ascertaining the gain or loss resulting from the business of the year, the inventories must be taken in accordance with instructions to be included in special regulations which will be furnished upon application to the collector of internal revenue.

397 Income from contract sales.—When property or merchandise is disposed of under a contract of sale, payments to be made in installments, title remaining in the vendor until the contract price is fully paid, the vendor will return as income that proportion of each installment payment, which the gross profit to be realized when the contract is fully performed, bears to the gross contract price. If by reason of the default in payment or for any other reason the vendor repossesses the property he will return as income the entire amount of the installments up to that time received, less the proportion of profits previously returned, and the repossessed property will be taken into stock at its then value, that is, at cost less a reasonable allowance for depreciation.

398 Art. 121. Contracting corporations.—Corporations engaged in contracting operations and which have numerous uncompleted contracts, which in some cases run for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work—that is, on jobs which have been finally completed—any and all moneys received in payment for completed jobs will be returned as income for the year in which the work was completed. If the gross income is arrived at by this method, the deduction from gross income should be limited to the expenditures made on account of such completed contracts.

399 Income on basis of estimates.—Or the percentage of profit from the contract may be estimated on the basis of percentage of completion

and payments made thereon, in which case the income to be returned each year during the performance of the contract will be computed upon the basis of the expenses incurred on such contract during the year; that is to say, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year; all under or over statements of income to be adjusted upon completion of the contract and return made accordingly. (T. D. 2161.)

In cases wherein contracts are fully performed in one year, 190 although payment therefor may be deferred until the next, the income resulting from the performance of the contract shall be returned for the year in which it was actually earned and determined.

Art. 122. Interest received from tax-free bonds.—The law requires 401 the debtor corporation to deduct one normal tax from the interest on bonds containing a tax-free covenant, and to account for same. Interest received by a corporation or individual on bonds held, whether they are guaranteed to be tax free or not, must be included in the income of the corporation or individual receiving the same and must be so accounted for in the return of annual net income.

The matter of complying with the covenant of the bond is a matter 402 to be adjusted between the debtor corporation and the bondholder.

If, however, it is clearly established by affidavit or otherwise that 403 the debtor corporation has actually withheld and paid to the proper officers of the United States the tax on such interest income, the recipient having returned such interest as income, may take credit against any tax to which subject on the basis of the return, for the tax so paid by the debtor corporation.

Art. 123. Farming corporations.—Corporations engaged in operating 404 plantations, ranches, stock farms; poultry farms, and lands used for raising fruit, truck, etc., including orchards of all kinds, shall make their returns on the basis of the products actually marketed and sold during the year, whether such products were produced or purchased and resold.

All deductions shall be based upon the legitimate expense incident 405 to the current year whether for the production of the present or future years, except that in a case wherein a corporation is engaged in producing crops which take more than a year from the time of planting, to the process of gathering and disposal, the income reported and expenses deducted should be determined upon the crop basis.

Cost of live stock purchased for resale is an allowable deduction 406 under the item of expense, but money expended for stock for breeding

purposes is regarded as capital invested, and amounts so expended do not constitute allowable deductions except as hereinafter stated.

407 Where stock has been purchased for any purpose, and afterwards dies from disease or injury or is killed by order of the authorities of a State or the United States, and the cost thereof has not been claimed as an item of expense in the preparation of previous returns, the actual purchase price of such stock, less any depreciation which may have been previously claimed, less also any insurance or indemnity recovered, may be deducted as a loss. The actual cost of property destroyed by order of the authorities of a State or of the United States, may, in like manner, be claimed as a loss; but if reimbursement is made by a State or the United States, in whole or in part, on account of stock killed or property destroyed, the amount received shall be reported as income for the year in which reimbursement is made. In determining the cost of stock for the purpose of ascertaining the deductible loss there shall be taken into account only the purchase price, and not the cost of any feed, pasturage, or care, which has been deducted as an expense of operations.

408 The cost of farm machinery represents a capital investment and, as such, is not an allowable deduction as an item of expense, but the cost of ordinary tools, of short life or insignificant cost, such as hand tools, including shovels, rakes, etc., may be included under this item.

409 There may be claimed a reasonable allowance for depreciation on farm buildings, farm machinery, and other physical property, including stock purchased for breeding purposes, but no claim for depreciation on stock raised or purchased for resale will be allowed. (T. D. 2123.)

410 Art. 124. Stock issued for stock of other corporation.—In a case wherein a corporation acquires from stockholders the stock of another corporation, giving in exchange therefor its own stock, it is held that the transaction is one by which the corporation acquiring the stock becomes the sole stockholder of the other corporation. As a result of this transaction no income accrues to the corporation whose stock is thus acquired. Neither will any income accrue to this corporation if later the holding corporation should cause the assets of the underlying company to be transferred to it for mere nominal consideration.

411 If, however, one corporation buys the assets of another and issues direct to the selling company its own capital stock in payment for the assets acquired, the transaction will be treated by the selling company as a sale of its assets, and the question as to whether profit or loss results from the sale will depend upon whether or not the value of the stock taken in payment for the assets is in excess of the fair mar-

ket price or value as of March 1, 1913, of the assets sold or of their cost accordingly as they were acquired by the selling company prior or subsequent to that date.

If the value of the stock is so in excess, the amount of such excess 412 will be taxable income for the year in which the assets were sold and must be so returned.

If the excess over value as of March 1, 1913, or over cost, as the 413 case may be, includes any surplus earned since March 1, 1913, upon which the income tax has been paid, the excess or profits resulting from the sale may be reduced by the amount of such tax-paid surplus.

If the purchasing corporation takes over all the assets including 414 accounts receivable, bills receivable, surplus, etc., of the selling corporation and assumes its liabilities, the amount so assumed will be considered a part of the purchase price, and to the extent that the entire purchase price exceeds the cost or value, as of March 1, 1913, as the case may be of the assets disposed, income will accrue to the selling company.

Art. 125. Operating corporation controlled by stock ownership.—A rail- 415 road company operating leased or purchased lines as an integral part of its line or system, and keeping no separate books of account as to such leased or purchased line, and the income from the operation of which can not be segregated, shall include in its income all receipts derived therefrom, and if bonded or other indebtedness of the leased or purchased line has been assumed by the operating company, it may deduct from its gross income the interest paid on such indebtedness, provided the interest so paid plus the interest paid on its own indebtedness is not in excess of the limit fixed by the law. In this event the leased or purchased line so long as it has a corporate existence will make return of annual net income setting out that on its own account it has neither income nor expenses, and that both are taken up in the return of the operating company, naming it.

Lessor must make return.—If the leased or purchased line keeps 416 separate books of account, or the income from its operations is, or can be segregated, or if the lessee or operating company pays it a certain rental, or in lieu of rental pays a certain per cent of dividends on its stock, interest on its bonds, taxes, etc., it (the lessor) will return the same as its income and will be subject to tax accordingly, and the lessee or operating company will make its return as though it were in no way related to the leased line.

Subsidiary to make return.—The rule hereinbefore set out is not 417 intended to apply to those cases wherein one corporation operating for itself is controlled by another through the ownership of a majority or all of its stock. In this case the controlling corporation is, for the purpose of this title, merely a stockholder, and the subsidiary company will be required to make a separate and distinct return,

accounting for all the income received by it during each taxable year (T. D. 2442) and the holding company will return as income any dividends or earnings received from the operating company.

DEDUCTIONS.

- 418 Art. 126. "Paid" or "actually paid."—"Paid" or "actually paid," within the meaning of this title, does not necessarily contemplate that there shall be an actual disbursement in cash or its equivalent. If the amount involved represents an actual expense or element of cost in the production of the income of the year, it will be properly deductible even though not actually disbursed in cash, provided it is so entered upon the books of the company as to constitute a liability against its assets, and provided further that the income is also returned upon an accrued basis.
- 419 If in the course of its business, a corporation credits the accounts of individuals, firms, or corporations with the amount of any expenses, interest, rentals, wages, etc., due them, thereby making them subject to the personal drawings of such creditors, or if expenses actually incurred are vouchered in definite amounts, the amounts so credited or vouchered may be treated as paid, and if the amounts so credited or vouchered are expenses incurred concurrently with and in the production of the income of the year, they may be allowably deducted therefrom.
- 420 This ruling must not be construed to allow as a deduction any accrued charges which if paid in cash or otherwise would not be deductible.
- 421 Art. 127. Approved accounting practices.—Pursuant to the foregoing provision, corporations keeping their accounts in strict accord with the methods prescribed by municipal, State, or Federal authorities, or in accord with approved standard accounting practices consistently followed from year to year, will be permitted to make their returns of annual net income on the basis of the accounts so kept, provided such systems of accounting clearly and correctly reflect the net income of each year.
- 422 Charged against current earnings.—All expenses, including interest, taxes, and other necessary charges, incidental and necessary to the creation or production of the gross income or properly chargeable against the same, being deductible from the gross income, whether paid in cash or entered on the books as a liability, can not, if unpaid, be carried forward to be deducted from the gross income of a subsequent year.
- 23 Each year's return complete.—Each year's return, both as to income and deductions therefrom, must be complete within itself. Charges, of whatever character, against income can not be cumulative. They

must be deducted from the income of the year in which incurred or not at all. The expenses, liabilities, or deficit of one year can not be used to reduce the income of a subsequent year.

The deductions must in all cases be such as are authorized and 424 within the limits fixed by law.

Art. 128. Previous year's charges not deductible.—A corporation hav- 425 ing the right under this rule to deduct all authorized allowances, whether paid in cash or set up as a liability, it follows that if it does not within any year pay or accrue certain of its expenses, interest, taxes, or other charges, and makes no deduction therefor, it can not deduct from the income of the next or any subsequent year any amounts then paid in liquidation of the previous year's liabilities.

Amended returns.—If, however, a corporation discovers or detects 426 expenses or liabilities which were due and payable during a preceding year, it will be permissible for it to make an amended return for the year to which such expense or liability applies, include such expense in the deductions of that year, and file a claim for refund for any taxes overpaid by reason of the failure to deduct such expense or liability in the original return of that year.

Any system of accounting which is not consistent with the purpose 427 and intent of the rules set out in this title, and with the general rules set out in these regulations for the ascertainment of net income, will not be accepted as a correct basis for making returns.

EXPENSES.

Art. 129. When deductible.—Expenses of operation and mainte- 428 nance shall include all expenditures for material, labor, fuel, and other items entering into the cost of the goods sold or inventoried at the end of the year, provided such expenditures have not been considered in determining the cost of goods or materials or purchases thereof during the year, when the income derived from operations is ascertained through inventory, and all other disbursements necessary to the operation of the business, except such as are required by the act to be segregated and stated separately in the return.

Expenditures which are taken into account in determining the 429 cost of products, finished or unfinished, are not to be again deducted as expenses of operation and maintenance.

Art. 130. Cost of material.—In ascertaining expenses proper to be 430 included in the deductions to be made under the item of "Expenses," corporations carrying materials and supplies on hand should include in such expense the charges for materials and supplies only to the amount that the same are actually consumed and used in operation and maintenance during the year for which the return is made, provided that the cost of such material and supplies has not been

taken into account in determining the net income for any previous year.

431 If a corporation carries materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the corporation to include in its expenses and deduct from gross income the total cost of such supplies and materials as were purchased during the year for which the return is made.

432 **Art. 131. Repairs.**—The cost of incidental repairs which neither add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided that the plant or property account is not increased by the amount of such expenditures. Such repairs, to the extent that they arrest deterioration, should have the effect to reduce the depreciation charge otherwise deductible.

433 **Art. 132. Additions and betterments.**—Amounts expended in additions and betterments or for furniture and fixtures which constitute an increase in capital investment and add to the value of the assets are not a proper deduction, but such expenditures when capitalized may be extinguished through annual depreciation deductions, which latter deductions will be computed upon the basis of the cost and probable life of the property.

434 **Art. 133. Spending money.**—So-called “spending or treating money” actually advanced by corporations to their traveling salesmen to be used by them as a part of the expense incident to selling the product of such corporations, is an allowable deduction in a return of income by such corporation. The deduction of such expenditures is conditioned upon a satisfactory showing that all the allowance claimed as a deduction was actually expended for and was an ordinary and usual expense incurred in selling the product or merchandise of the corporation. (T. D. 2090.)

435 **Art. 134. Donations deductible, when.**—Donations made by a corporation for purposes connected with the operation of the property, when limited to charitable institutions, hospitals, or educational institutions, conducted for the benefit of its employees or their dependents, shall be a proper deduction as ordinary and necessary expenses. Such deduction should, however, be reduced by any amount repaid to the corporation by the employees.

436 Donations which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business are allowable deductions from gross income in ascertaining net income subject to the income tax; for example, a street railway corporation donates a sum of money to an organization intending to hold a convention in the city in which it operates, with the expectation that the holding of such convention will augment its income

through a greater number of people using the cars. In such case the donations would be an allowable deduction, the deduction to be reduced by any portion of the donation which may be returned to the corporation.

Art. 135. Donations not deductible.—Donations made to employees 437 and others, and which do not have in them the element of compensation, are considered gratuities and are not allowable deductions from gross income as expenses of operation or maintenance or under any other item. (T. D. 2090.)

Art. 136. Pensions.—Amounts paid for pensions to retired em- 438 ployees, or to their families or others dependent upon them, or on account of injuries received by employees, or lump-sum amounts paid as compensation for injuries, are proper deductions as "ordinary and necessary expenses." Such deduction shall be limited to the amount not compensated for by insurance or otherwise.

No deduction shall be made for contributions to a pension fund 439 the resources of which are held by the corporation, the amount deductible in such case being the amount actually paid to the employee.

Art. 137. Salary paid after death of employee.—When the amount of 440 the salary of an officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, no services being rendered by the widow or heirs, such payment is not "ordinary and necessary" expense of transacting business and does not constitute an allowable deduction.

Art. 138. Bonuses or additional compensation.—Special payments, 441 sometimes denominated as gifts or bonuses to employees of corporations, will constitute allowable deductions from gross income in ascertaining net income for the purpose of the income tax, when such payments are made in good faith and as additional compensation for the services actually rendered by the employees. If such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered, they will be regarded as a part of the wage or hire of the employee, and therefore an ordinary and necessary expense of operation and maintenance, and as such deductible from gross income.

Special payments made to officers or employees who are stock- 442 holders, in the guise of additional salaries or compensation, the amount of which is based upon or bears a close relationship to the stockholdings of such officers or employees or the capital invested by them in the business of the company, will be regarded as a special distribution of profits, or compensation for the capital invested, and not payment for services rendered. Payments under such latter conditions being in the nature of dividends, will not be deductible from gross income.

- 443 Salaries of officers or employees who are stockholders will be subject to careful analysis, and if they are found to be out of proportion to the volume of business transacted, or excessive when compared with the salaries of like officers or employees of other corporations doing a similar kind or volume of business, the amount so paid in excess of reasonable compensation for the services will not be deductible from gross income, but will be treated as a distribution of profits.
- 444 **Art. 139. Compensation paid in stock.**—Compensation paid an employee in capital stock of the corporation may be deducted as an expense if so charged on books at the actual value of such stock, and the recipient of such stock, if he be a taxable person, will return such stock at the same value as income.
- 445 **Art. 140. Permanent improvements under lease.**—The cost of erecting permanent buildings, or of making permanent improvements on ground leased by a company, is held to be an additional rental and is therefore a proper deduction from gross income, provided such buildings and improvements, under the terms of the lease, revert to the owner of the ground at the expiration of the lease. In such case, however, the cost will be prorated according to the number of years constituting the term of the lease and the annual deduction will be an aliquot part of such cost. (As to income to lessor, see paragraph 50, page 11, these regulations.)
- 446 **No depreciation.**—The cost of the buildings being a rental charge and deductible on the prorated basis, the lessee corporation will not be permitted to deduct from gross income any depreciation with respect to such buildings, but the cost of incidental repairs necessary to keep them in an efficient condition for the purposes of their use, may be deducted as an expense of operation and maintenance. (T. D. 2137.)
- 447 If, however, the life of the improvement is less than the life of the lease, the depreciation may be taken by the lessee, based upon the cost and life of the improvement.
- 448 **Art. 141. Redemption of trading stamps.**—Corporations, mercantile or otherwise, which issue trading stamps, coupons, etc., for the purpose of increasing their business, which stamps or coupons are redeemable in merchandise, may allowably deduct from gross income as a business expense the amount which such corporations actually expend for such stamps or coupons, and also the actual cost to the corporations of the merchandise given in redeeming the same.
- 449 This rule contemplates that a reserve set up as a liability equal to the redemption value of the stamps or coupons issued is not, as such, an allowable deduction, the deduction being limited to the cost of the stamps or coupons and the merchandise with which they are redeemed.

Art. 142. Earnings of public utility paid to city, etc.—In case of a 450 public utility constructed, operated, or maintained by a corporation under contract with any city, State, Territory, or the District of Columbia, with an agreement that a portion of the net earnings of such public utility corporation shall be paid to the city, State, Territory, or the District of Columbia, the amount so paid may be deducted by the public utility company as a necessary expense of transacting business. (T. D. 2090.)

Art. 143. Lobbying expenses.—Sums of money expended for lobby- 451 ing purposes, the promotion or defeat of legislation, the exploitation of propaganda, and contributions for campaign expenses are held not to be an ordinary and necessary expense in the operation and maintenance of the business of a corporation, and are therefore not deductible from gross income in arriving at the net income upon which the income tax is computed. (T. D. 2137.)

Art. 144. Reserves for insurance.—Funds set aside by a corporation 452 for insuring its own property are not a proper deduction, but if such funds are set aside, or a reserve therefor is set up, any loss actually sustained and charged to such funds or reserves may be deducted.

Art. 145. Expense incurred in sale of capital stock.—Any and all ex- 453 penses incidental to or connected with the selling of the capital stock (common or preferred) of a corporation for the purpose of raising capital to be by it invested in property or employed in the business for which the corporation is organized are not an "expense of operation and maintenance" within the meaning of this title, and such expense is not an allowable deduction from the gross income, for the reason that such an expense is incurred in a capital transaction; that is, the raising of capital to be invested or employed in the business.

Such expense, like the discount at which the shares of stock may 454 be sold, has the effect only to reduce the available capital of the corporation and can not be used to reduce the income from operations; that is to say, any expense incident to the bringing of capital into the company, whether it be a new or a going concern, can not be recouped out of or charged against the operating income. It is a capital loss or expense properly chargeable against the proceeds of the sale of the stock and reduces the capital rather than the earnings of the company.

Art. 146. Depositors' guaranty fund.—Banking corporations which, 455 pursuant to the laws of the States in which they are doing business, are required to set apart, keep, and maintain in their banks the amount levied and assessed against them by the State authorities as a "Depositors' guaranty fund," may deduct from their gross income in their returns of annual net income the amount so set apart each year to this fund, provided that such fund, when set aside and carried to the credit of the State banking board or other duly au-

- 456 thorized State officer, ceases to be an asset of the bank, but may be withdrawn in whole or in part, upon demand by such board or State officer to meet the needs of these officers, as required by State laws, in reimbursing depositors in insolvent banks, and provided further that no portion of the amount thus set aside and credited is returnable, under the existing laws of the State, to the assets of the banking corporation.
- 457 If, however, such amount is simply set up on the books of the bank as a reserve to meet a contingent liability, and remains an asset of the bank, it will not be deductible except as it is actually paid out as required by law and upon demand of the proper State officers. (T. D. 2152.)

LOSSES.

- 458 Art. 147. When deductible.—The deduction for losses must represent losses not compensated for by insurance or otherwise and which were charged off and actually sustained within the year as evidenced by closed and completed transactions.
- In the case of the sale of assets—real, personal, or mixed—the loss will be the difference between the cost thereof, or the value as of March 1, 1913, if acquired before that date, and the price at which disposed of. When the loss is claimed through the destruction of property by fire, flood, or other casualty the amount deductible will be the difference between the value as of March 1, 1913, or the cost of the property and the salvage value thereof, including in the latter value the amount, if any, that has been or should have been set aside and deducted in the current or previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained.
- 459 Art. 148. Shrinkage in securities.—A corporation possessing securities, such as stocks and bonds, can not allowably deduct from gross income any amount claimed as a loss on account of the shrinkage in value of such securities through fluctuations of the market or otherwise; the only loss to be allowed in such cases is that actually suffered when the securities mature or are disposed of.
- 460 In the case of banks or other corporations which are subject to supervision by State or Federal authorities, and which, in obedience to the orders of such supervisory officers, charge off as losses, amounts representing an alleged shrinkage in the value of property, real, personal, or mixed, the amounts so charged off do not constitute allowable deductions. Deductible losses are those only which are determined upon the basis of a closed or completed transaction. (T. D. 2005, 2130, 2152.) The foregoing applies only to owners and investors and not dealers in securities, as to which see T. D. 2609.
- 461 Art. 149. Discount on bonds issued prior to 1909.—Discount on bonds issued and sold prior to the year 1909, if such discount was then

charged against surplus or against the income of the year in which the bonds were sold, is held not to be deductible from the income of subsequent years, for the reason that the charging off prior to January 1, 1909, of the entire amount of the discount constitutes a closed transaction, and such transaction can not be reopened for the purpose of reducing the taxable income of a corporation for subsequent years by deducting therefrom an aliquot part of the discount. (C. & A. R. R. v. U. S., Court of Claims).

Art. 150. Discount and expenses to be amortized.—If, however, the 462 bonds were sold subsequent to January 1, 1909, at a discount, and the amount of the discount was then charged off on the books, either against earnings or surplus, but not deducted in the corporation's return of net income, such discount as was not then deducted, may be spread over the life of the bonds, and an aliquot part of the discount may be deducted from the gross income of each year until the bonds mature or are redeemed.

In cases wherein a corporation sells its bonds at a discount plus a 463 commission for selling, the amount of such discount and commission, together with other expenses incidental to issuing the bonds, constitutes a loss, the aggregate amount of which loss will, for the purpose of an income tax return, be prorated over the life of the bonds sold, and the amount thus apportioned to each year will be deductible from the gross income of each such year until the bonds shall have been redeemed.

If a corporation having sold its bonds at a discount, the discount 464 having been deducted from gross income, later repurchases or redeems the bonds at a price less than par, the difference between the price at which they are redeemed and their par value will be returned as income. If bonds are sold at a premium, the premium must be returned as income.

Art. 151. Bad debts.—Losses which may be properly deducted from 465 gross income on account of bad debts or doubtful accounts are those losses which have been definitely ascertained to have occurred and which were charged off during the year for which the return is made. It is not essential that the bad debt or account shall be proved worthless by legal proceedings before the deduction may be allowed, but the corporation must not only be satisfied that the debt or account is worthless, but must be able to satisfy the Commissioner or Collector of Internal Revenue that the accounts charged off were definitely determined at the time to be worthless and that they had not been recognized as worthless or without value prior to the beginning of the year for which the return is made.

Loss must be definite.—In the absence of legal proceedings to deter- 466 mine the collectibility of a debt or account, the question of whether or not it is an asset without value will depend largely upon the

judgment of the creditor. The mere writing down of the value of an account does not constitute such a loss as may be allowably deducted. The deduction will be permissible only when the debt or account is written out of the assets of the corporation.

467 **Art. 152. Loss due to retirement of bonds.**—In a case wherein a corporation, under the terms of its indenture, securing an issue of bonds is required annually or at certain specified periods to purchase and retire a certain number of its bonds and in doing so pays more than par for the bonds, the loss sustained is an allowable deduction from gross income for the year in which such purchase is made, under the following conditions:

468 **First.** If the bonds were sold at par, then the loss is the difference between par and the price at which they were repurchased for retirement.

469 **Second.** If the bonds were sold at a premium and such premium was accounted for as income for the year in which issued, then the difference between par and the repurchase price may be deducted as loss, but if the premiums at which the bonds were issued had not been carried into the income account then the loss to be claimed should be the difference between the price at which the bonds were sold and the price at which they were repurchased.

470 **Third.** If the bonds were sold at a discount and the discount was charged against the earnings of the year in which issued, the difference between par and the repurchase price may be deducted as a loss, but if the discount on the bonds was prorated over the life of the bonds and the annual proportion charged against the yearly income, the amount to be charged off as a loss for the year in which the bonds are repurchased for retirement should be the difference between the price at which the bonds were sold and the repurchase price minus an allowance for the sum that had been charged off annually on account of the prorated discount on such bonds. (T. D. 2137.)

471 **Art. 153. Irrigation bonds.**—District irrigation bonds generally are a lien upon the real estate affected by the irrigation project, and until a corporation holding such bonds has taken the necessary action to protect its interests and enforce the collection of the bonds the corporation will not be allowed to deduct from gross income, as a loss, the face value or any estimated amount supposed to represent a loss or shrinkage in the value of such bonds. Any estimated shrinkage in the value of bonds or other securities does not constitute a loss within the meaning of this title. So long as the value of a security is uncertain or unknown a loss can not be definitely ascertained and is therefore not deductible. (T. D. 2005, 2130, 2152.)

472 **Art. 154. Death of live stock.**—A corporation engaged in raising and selling sheep, cattle, or other live stock can not deduct from

gross income any amounts claimed as a loss on account of the death of such live stock through exposure or otherwise, unless and to the extent that such stock was specifically paid for in cash or its equivalent. If the stock is raised and fed upon the farm or range, the cost of feeding and raising the stock will be included as operating expenses of the corporation, and no loss of capital is sustained when the live stock perishes. If, however, the live stock was purchased and the cost thereof was not charged into expenses and as such deducted from gross income, the deductible loss will be the actual purchase price of the stock which perished, less any depreciation which had been previously charged off and deducted with respect to such purchased live stock. (T. D. 2153.)

Art. 155. Voluntary removal of buildings.—Loss due to the voluntary 473 removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income, in an amount representing the difference between the cost of such property demolished or scrapped and an amount measuring a reasonable allowance for the depreciation which the property had undergone prior to its demolition or scrapping; that is to say, the deductible loss is only so much of the original cost, less salvage, as would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to its destruction.

Art. 156. Erection of new buildings.—When a corporation buys real 474 estate upon which is located a building or buildings, which it proceeds to raze, with a view to erecting thereon another building or buildings, it will be held that the corporation has sustained no deductible loss by reason of the demolition of the old building or buildings. In such case it will be considered that the value of the real estate, exclusive of old improvements, is equal to the purchase price of the land and buildings.

Art. 157. Sale of patents.—A corporation disposing of patents by 475 sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of March 1, 1913, if acquired prior to that date, or between the selling price and the cost, if acquired subsequent to that date. The profit or loss thus ascertained should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patents since March 1, 1913, or since the date of purchase if acquired subsequent to that date.

Art. 158. Losses on judgments.—Any amount paid pursuant to judg- 476 ment or otherwise on account of damages is deductible from gross income to the extent of, and when the amount is actually paid, less any amount of such damages as may have been compensated for by insurance.

DEPRECIATION.

- 477 **Art. 159. Depreciation deductible.**—Section 12, item “second,” authorizes corporations to deduct from the gross amount of their income received within the year all losses actually sustained and charged off within the year, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade.
- 478 Depreciation as here used must be differentiated from depletion, obsolescence, and other losses elsewhere provided for in these regulations.
- 479 The deduction for depreciation should be the amount of the loss occurring during the year to which the return relates, estimated on the cost of the physical property with respect to which such deduction is claimed, which loss results from wear and tear due to the use to which the property is put and which loss has not been made good through expenditures for renewals, replacements, and repairs, deducted under the heading of expense for maintenance and operation.
- 480 **Must be charged off.**—Within the purview of this item depreciation, to an amount measuring the decline in value due to exhaustion, wear and tear of property arising out of its use, is a loss. This loss, in order to constitute an allowable deduction from gross income, must be charged off. The particular manner in which the amount shall be charged off is not material, except that the amount measuring a reasonable allowance for depreciation must be either deducted directly from the book value of the assets or credited to a depreciation reserve account, and as such shall be reflected in the annual balance sheet. (See sec. 1001, act of Oct. 3, 1917.)
- 481 **Art. 160. Loss on inventory by obsolescence or damage.**—No deductions from the inventory value of merchandise or material will be allowed except in cases in which the inventory includes goods or materials which by reason of obsolescence or damage are unsalable. When such deduction is claimed the facts connected therewith, including a statement of the cost of the goods, the value at which they were inventoried, and their present condition, must be filed with the return.
- 482 **Art. 161. Diversion of fund.**—If a corporation at the end of the year finds it has a certain net income, and, without making any provision for depreciation, distributes such net income among its stockholders as dividends, it will be estopped from claiming in its returns of annual net income for such year any deduction on account of depreciation unless it is shown conclusively that the property account has been reduced by the amount of depreciation claimed, or unless such

amount has been credited to a depreciation reserve account, and such amount was in fact a reasonable allowance.

The depreciation allowance authorized by section 12 is intended to 483 provide a fund out of which the loss due to use, wear, and tear may be made good, and the fund thus created can not be diverted to the payment of dividends; that is to say, a deduction made under the guise of depreciation can not measure a loss and at the same time be used in the payment of dividends.

The fact that no reserve was made for depreciation indicates that 484 there is no loss on this account to be provided for.

Art. 162. Rate for computing.—No definite rate has been fixed by 485 which an allowable deduction on account of depreciation in the value of any class of property subject to wear and tear is to be computed, but it is contemplated that this allowance shall be computed upon the basis of the cost of the property and the probable number of years constituting its life. The deduction to be allowed relates solely to loss due to use, wear and tear, and the matter of obsolescence is not relevant, inasmuch as when the property becomes obsolete a deduction for the loss sustained thereby, representing the difference between the cost and the amount of depreciation previously charged off or which should have been charged off in prior years, will be allowed. (See arts. 178 and 179.)

Rate based upon life.—In the case of buildings the deduction on 486 account of depreciation shall not include any allowance for an estimated loss due to lessening of rental value, nor shall the computation of the deduction be influenced by the changed environment after a period of years, nor by its lack of adaptability to the use originally intended nor to any other outside influence affecting its value, but an allowable depreciation shall be determined solely upon the estimated life of such buildings after making due allowance for ordinary repairs, the cost of which may be deducted as expenses for maintenance and operation.

Assets not subject to wear and tear.—Assets of any character what- 487 ever which are not affected by use, wear and tear (except patents, copyrights, etc.) are not subject to the depreciation allowance authorized by this act. Real estate as such, and as distinct from the improvements thereon, is not reduced in value by reason of wear and tear, and it therefore follows that the "allowance" contemplated as an offset to depreciation in the case of real estate corporations does not apply to the ground, but is intended to measure the decline, by reason of wear and tear, in the value of the improvements. (T. D. 2152.)

- 488 **Art. 163. Value to be estimated, when.**—In determining the cost of the real estate upon which depreciable property is located it frequently occurs that no segregation is made of the cost of buildings as separate and distinct from the cost of the ground upon which such buildings stand. In such cases where the actual cost of the buildings or improvements at the time they were taken over by the corporation can not be definitely determined, it will be sufficient for the purpose of determining the rate of depreciation to be used in computing the amount which will be deductible from gross income to estimate the actual value at the time acquired of buildings or improvements if acquired after March 1, 1913, or the fair market price or value as of that date if the property was acquired prior to March 1, 1913, the value in either case to be reduced by the amount of depreciation previously sustained. (T. D. 2137, 2152.)
- 489 **Art. 164. Use of depreciation reserve.**—Depreciation set up on the books and deducted from gross income can not be used for any purposes other than in making good the loss sustained by reason of the wear and tear of the property with respect to which it is claimed.
- 490 If, however, an investment is made in extensions, additions, or betterments of the company's own property, representing a part or the whole of the credit balance of the depreciation reserve account, such investment will not be considered a misuse or diversion of the depreciation deduction otherwise allowable.
- 491 **Art. 165. Depreciation in excess of cost.**—If it develops that by reason of underestimating the life of the property or by overestimating the rate of deterioration an amount in excess of the yearly depreciation has been taken, the rate applicable to future years should at once be reduced and the balance of the cost of the property not provided for through a depreciation reserve should be spread over the estimated remaining life of the property.
- 492 **Art. 166. Sinking-fund reserve.**—When a corporation sets aside a part of its earnings for the purpose of creating a sinking fund with which to retire its bonded or other indebtedness, the annual additions to such funds are not allowable deductions from gross income as or in lieu of depreciation or on any other account. The earnings thus set aside are an asset of the corporation and any accretion thereto must be accounted for as income. (T. D. 2161.)
- 493 This ruling will not, however, forbid the deduction from gross income of a reasonable allowance for depletion of natural deposits even through the amount so deducted be used in whole or in part in the payment of its bonded or other indebtedness.
- 494 **Art. 167. Good will.**—“Good will” represents the value attached to a business over and above the value of the physical property, and is such an intangible asset that it is not subject to wear and tear, and

no claim for depreciation in connection therewith can be allowed. Any loss resulting from or on account of an investment in "good will" can be determined only when the property or business to which the good will attaches is sold or disposed of, in which case the profit or loss will be determined upon the basis of the value of the assets including good will if acquired prior to March 1, 1913, or their cost if acquired subsequent to that date.

Art. 168. No deduction for depreciation of good will, trade-marks, and trade brands.—No deduction will be allowed for the depreciation of good will, trade-marks, and trade brands. If such assets shall have been purchased at a determined price and shall be later sold at a price less than such cost, or less than their determined fair market value as of March 1, 1913, if acquired prior to that date, the amount by which the selling price is less than the cost or value, as the case may be, will be a loss deductible from the gross income of the year in which such assets were sold. 495

Art. 169. Merchandise.—Depreciation computed on total invoice cost of merchandise in stock is not an allowable deduction, except that if any portion of the merchandise in stock is unsalable by reason of obsolescence or damage, a depreciation deduction not in excess of the decline in value during the taxable year will be allowed. 496

DEPLETION.

OIL AND GAS PROPERTIES.

Art. 170. Sections 5 and 12 of the act of September 8, 1916, as amended by the act of October 3, 1917, authorize individuals and corporations owning and operating gas or oil properties, to deduct from gross income— 497

"A reasonable allowance * * * for actual reduction in flow and production, * * * provided that when the allowance authorized * * * shall equal the capital originally invested, or in case of purchase made prior to March 1, 1913, the fair market value as of that date, no further allowance shall be made." 498

The essence of this provision of law is that the owner or operator of this character of properties shall secure through an aggregate of annual depletion deductions, the return of the amount of capital actually invested, or an amount not in excess of the fair market value as of March 1, 1913, of the properties owned prior to that date. 499

For the purpose of determining the amount of capital to be returned through annual deductions, operators may be divided into two classes, (a) operators who own the fee, and (b) operators who own a lease or leases. 500

In the case of the operating fee owner, the amount returnable through depletion deductions is the fair market value of the property 501

(exclusive of the cost of physical property) as of March 1, 1913, if acquired prior to that date, or the actual cost of the property if acquired subsequent to that date, plus, in either case, the cost of development (other than the cost of physical property incident to such development) up to the point at which the income from the developed territory equals or exceeds the deductible expenses.

- 502 In the case of a lessee, the capital thus to be returned is the amount paid in cash or its equivalent as a bonus or otherwise by the lessee for the lease, plus also all expenses incurred in developing the property (exclusive of physical property) prior to the receipt of income therefrom sufficient to meet all deductible expenses, after which time as to both owner and lessee, such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the drilling of wells and further development of the property, may, at the option of the operator, be deducted as an operating expense or charged to capital account.
- 503 If, in exercising this option, the individual or corporation charges the expense of drilling wells or further development to capital account, the same, in so far as such expense is represented by physical property, may be taken into account in determining a reasonable allowance for depreciation during each year until the property account thus augmented has been extinguished through annual depreciation deductions, after which no further deduction on this account will be allowed. In the case of a going or producing business, the cost of drilling nonproductive wells may be deducted from gross income as an operating expense.

ESTIMATE OF PROBABLE RESOURCES.

- 504 In the case of either an owner or lessee it will be required that an estimate, subject to the approval of the Commissioner of Internal Revenue, shall be made of the probable quantity of oil or gas contained in or to be recovered from the territory with respect to which the investment is made. The invested capital (value as of Mar. 1, 1913, or cost, if acquired subsequent to that date, plus the cost of development, other than cost of physical property, up to the point of expense-paying production, in the case of an owner, and the amount actually paid for the lease plus cost of development, other than cost of physical property, up to the same point, in the case of a lessee) will be divided by the number of units of oil or gas so estimated to be contained in or to be recovered from the territory, and the quotient will be the per unit cost or amount of capital invested in each unit recoverable. This quotient, or per unit cost, when multiplied by the number of units removed from the territory during any one year,

will determine the amount which may be allowably deducted from the gross income of that year on account of depletion of assets or as a return of invested capital until the total of such deductions shall equal the capital invested.

Every individual or corporation entitled to a deduction on account 505 of the depletion of the property under operation or for a return of the capital invested with respect to the same shall keep an accurate ledger account, in which, in the case of fee owner, shall be charged the fair market value as of March 1, 1913, or the cost, if acquired subsequent to that date, of the oil or gas property, plus cost of development as hereinbefore defined, or, in the case of a lessee, the amount actually originally invested in the lease and its development. This account shall be credited with the amount claimed and allowed each year as a deduction on account of depletion or as a return of capital, to the end that when the credits to the account equal the debits no further deduction on either account, with respect to this property and the capital invested therein, will be allowed. Or, in lieu of a direct credit to property account, the amount so claimed and allowed as a deduction may be credited to a depletion reserve account.

WHERE RESOURCES ARE UNCERTAIN.

If for any reason the quantity of oil or gas in the property can 503 not be determined with any degree of certainty, the depletion deduction will be computed in accordance with the rule set out in Treasury Decision 2447, except that lessees may compute their deduction for return of capital (cost of lease and development) in the same manner as owners in fee; that is, they may extinguish such capital on the basis of the reduction in flow and production as compared with the preceding year, or, in the case of leasehold properties brought in or developed during the year, the depletion deduction may be computed on the basis of the decline in settled flow and production, as evidenced by tests and gauges made at the end of the year as compared with similar tests and gauges made at the time the settled flow was determined.

For the purpose of computing the depletion the territory compre- 507 hended in a given lease will be considered the unit with respect to which the depletion deduction may be claimed and allowed.

If the operator is the owner of the fee the value determined and 508 set up as of March 1, 1913, or the cost of the property if acquired subsequent to that date, or, if the operator is a lessee, the amount actually paid for the lease, plus, in the case of both owner and lessee, the cost of subsequent development, exclusive of physical property, if such cost is capitalized, will be the basis for determining the de-

pletion deduction or the deduction for return of capital for all subsequent years during the continuance of the ownership under which the value was fixed or by which the investment was made, and during such ownership there can be no revaluation for the purpose of this deduction if it should be found that the quantity of oil or gas in the property was underestimated at the time the value was fixed or the property was acquired, or at the time the lease contract was entered into or purchased.

- 509 This rule will not, however, be so construed as to forbid an operator from redistributing the invested capital over the estimated number of units remaining in the territory under operation if a subsequent increase of invested capital should render this necessary in order to determine the amount of such capital applicable to each unit, provided that when such redistribution is made the total capital invested will be reduced by the amount previously charged off and deducted on account of depletion or as a return of capital.

ADDITIONAL DEPRECIATION FOR MACHINERY, ETC.

- 510 Both owners and lessees operating oil or gas properties will, in addition to and separate from the deduction allowable for the depletion or return of capital as hereinbefore provided for, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., the amount deductible upon this account to be such an amount, based upon its capitalized value (cost) equitably distributed over its useful life, as will bring it to its true salvage value when no longer useful for the purpose for which such property was acquired.
- 511 As to both fee owner and lessee, the capital invested in physical property, upon which the depreciation deduction is computed, should be segregated in the books of account from that invested in the oil or gas territory or in the lease or leases, with respect to which the deduction for depletion or return of capital is claimed, and credits for depreciation may be made in the same manner as hereinbefore provided for depletion.

STATEMENT REQUIRED.

- 512 To each return made by an individual or corporation owning and operating oil or gas properties there should be attached a statement showing—
- 513 (1) (a) The fair market value of the property (exclusive of machinery, equipment, etc.) as of March 1, 1913, if acquired prior to that date, or (b) the actual cost of the property if acquired subsequent to that date;

- (2) How the fair market value as of March 1, 1913, was ascer- 514
tained;
- (3) The estimated quantity of oil or gas in the sand at the time the 515
value or cost was determined;
- (4) Amount of capital applicable to each unit; 516
- (5) The quantity of oil or gas produced during the year for which 517
the return is made;
- (6) Any other data which would be helpful in determining the 518
reasonableness of the depletion deduction.

If the operator is a lessee that fact should be stated, and to the 519
return made by such lessee there should be attached a statement
showing—

- (1) The amount of cash or its equivalent actually paid for the 520
lease;
- (2) The amount expended for development prior to the receipt 521
of income from the output, sufficient to pay operating expenses;
- (3) The total capital thus invested; 522
- (4) The estimated quantity of oil or gas in the territory com- 523
prised in the lease;
- (5) The amount of capital applicable to each unit; 524
- (6) The number of units removed during the year for which the 525
return is made, and other data that would be helpful in determin-
ing whether or not the deduction made for the return of capital
is a reasonable allowance.

MINING CORPORATIONS.

Art. 171. Paragraphs "seventh" and "eighth" of section 5 (a) 526
and paragraph "second" of section 12 (a) of Title I of the act of
September 8, 1916, authorize individuals and corporations to deduct
from gross income "a reasonable allowance for exhaustion, wear and
tear of property, and * * * (b) in the case of mines, a reasonable
allowance for depletion thereof not to exceed the market value in
the mine of the product thereof which has been mined and sold
during the year for which the return and computation are made";
provided, that when the sum of the annual allowances for depletion
equals the capital originally invested, or in case of purchase prior
to March 1, 1913, the fair market value as of that date of the mineral
"in place," no further allowance on this account shall be made.

Ownership of the mine content at the time for which computation 527
is made is an essential prerequisite to an allowable deduction for
depletion.

The deduction in the case of a lessee will be limited to an amount 528
equal to the capital actually invested in the lease, without regard to
value as of March 1, 1913, or any other date.

- 529 The paragraphs of the title above referred to authorize in the case of mine owners two classes of deductions to take care of the wasting of assets, namely, (a) depreciation, (b) depletion.

DEDUCTIONS AND VALUATION.

- 530 Art. 172. If the property was acquired by purchase or otherwise (other than by lease) prior to March 1, 1913, the amount of invested capital which may be extinguished through annual depletion deductions from gross income will be the fair market value of the mine property so acquired, as of March 1, 1913. The value contemplated herein as the basis for depletion deductions authorized by this title must not be based upon the assumed salable value of the output under current operative conditions, less cost of production, for the reason that the value so determined would comprehend the profits to be realized from operation of the property.
- 531 Neither must the value determined as of March 1, 1913, be speculative, but must be determined upon the basis of the salable value *en bloc* as of that date of the entire deposit of minerals contained in the property owned, exclusive of the improvements and development work; that is, the price at which the natural deposits or mineral property as an entirety in its then condition could have been disposed of for cash or its equivalent.
- 532 The *en bloc* value having been thus ascertained, an estimate of the number of units (tons, pounds, etc.) should be made. The *en bloc* value divided by the estimated number of units in the property will determine the per unit value, or amount of capital applicable to each unit, which, multiplied by the number of units mined and sold during any one year, will determine the sum which will constitute an allowable deduction from the gross income of that year on account of depletion.
- 533 Deductions computed on a like basis may be made from year to year during the ownership under which the value was determined, until the aggregate *en bloc* value as of March 1, 1913, of the mine or mineral deposits shall have been extinguished, after which no further deduction on account of depletion with respect to this property will be allowed to the individual or corporation under whose ownership the *en bloc* value was determined.

FAIR MARKET VALUE, MARCH 1, 1913.

- 534 The precise detailed manner in which the estimated fair market value of mineral deposits as of March 1, 1913, shall be made must naturally be determined by each individual or corporation interested, and who is the owner thereof, upon such basis as must not compre-

hend any operating profits, the estimate in all cases to be subject to the approval of the Commissioner of Internal Revenue.

In any case in which a corporation uses for purposes of its income return an estimate of the value of mines or of mineral lands or properties as of March 1, 1913, as the basis of computing amounts to be deducted for depletion or return of capital, this department in passing upon the accuracy and fairness of such estimate will attach due weight to the market value of the stock of the corporation on March 1, 1913, and also to sworn statements as to the value of capital stock of the corporation filed at any time thereafter for purposes of the special excise tax on corporations based on value of their capital stocks imposed by Title IV of the act of September 8, 1916. 535

In any case in which any depletion deduction is computed on the basis of the cost or price at which any mine, mineral lands, or properties were acquired the corporation will be required upon request of the Commissioner of Internal Revenue to show that the cost or price at which the property was bought was fixed for purposes of a bona fide purchase or sale by which the property passed to an owner in fact as well as in form, different from the vendor. No fictitious or inflated cost or price will be permitted to form the basis of any calculation of a depletion deduction, and in determining whether or not the price or cost at which any purchase or sale was made represented the actual market value of the property sold due weight will be given to the relationship or connection existing between the party or parties selling the property and the buyer thereof. 536

RECORDS TO BE KEPT.

Every individual or corporation claiming and making a deduction for depletion of natural deposits shall keep an accurate ledger account, in which shall be charged the fair market value as of March 1, 1913, or the cost, if the property was acquired subsequent to that date, of the mineral deposits involved. This account shall be credited with the amount of the depletion deduction claimed and allowed each year, or the amount of the depletion shall be credited to a depletion reserve account, to the end that when the sum of the credits for depletion equals the value or cost of the property no further deduction for depletion with respect to this property will be allowed. The value determined and set up as of March 1, 1913, or the cost of the property if acquired subsequent to that date will be the basis for determining the depletion deduction for all subsequent years during the ownership under which the value was fixed, and during such ownership there can be no revaluation for the purpose of this deduction if it should be found that the estimated quantity, 537

of the mineral deposit was understated at the time the value was fixed or at the time the property was acquired.

- 538 In cases wherein the quantity of the mineral deposit in the mine prior to March 1, 1913, can not be estimated with any degree of accuracy, it will be necessary, if depletion deductions are to be taken, for the individual or corporation owning the deposits, with the best information available, to arrive at the fair market value of the property as of March 1, 1913; that is, its fair cash value en bloc, if such value is believed to be other than its original cost, which value, during the period of the ownership under which it was determined, shall be final and shall be charged to the property account as hereinbefore indicated, and then, on the basis of the most probable number of units in the property, the per unit value shall be determined as the basis for computing annual depletion allowances, this method and allowances to be continued until, but not beyond, the time when the value as of March 1, 1913, shall have been extinguished.

WHEN TO USE ORIGINAL COST BASIS.

- 539 The original cost of the mineral deposit may be taken as the basis for computing annual depletion deductions if the fair market value as of March 1, 1913, as hereinbefore required, can not be ascertained otherwise, allowance being made for minerals which may have been removed prior to that date.
- 540 In cases wherein a mineral property was acquired subsequent to March 1, 1913, the same rule for computing the annual depletion deduction will apply, except that in such case the basis of the computation will be the actual cost rather than the value as of March 1, 1913.
- 541 A lessee corporation is not entitled to any depletion deduction as such, but if such lessee, in addition to royalties, pays a stipulated sum for the right to explore, develop, and operate a mine, such sum may be spread ratably over the estimated number of units in the mine, and thus ascertain the amount of invested capital or bonus payment applicable to each unit. The per unit cost thus ascertained will be multiplied by the number of units removed from the mine during any one year and the result will be the amount that may be deducted from the gross income of that year as a return of the capital invested. In the case of both mine owner and lessee no deduction for depletion or return of capital will be allowed when the invested capital has through the aggregate of all such deductions been extinguished.

LESSEE'S COMPUTATION OF INVESTED CAPITAL.

- 542 For the purpose of computing this deduction in the case of a lessee company, the actual amount of the bonus payment and not a value

as of March 1, 1913, will be considered the invested capital to be returned through the aggregate of the annual deductions.

To the return made pursuant to the above rule there should be attached a statement setting out (1) whether the operator is a fee owner or lessee; (2) in the case of a fee owner, (a) the fair market value of the mineral deposits as of March 1, 1913, if the property was acquired prior to that date, (b) the cost of the mineral property if acquired subsequent to that date; (3) the method by which the value as of March 1, 1913, was determined, in case the property was acquired prior to that date; (4) the estimated quantity in units in the mine as of March 1, 1913, or at the date of purchase if acquired subsequent to that date; (5) amount of capital applicable to each unit; (6) the number of units removed and sold during the year for which the return was made; and (7) any other data which would be helpful in determining the reasonableness of the depletion deduction claimed in the return. 543

In the case of a lessee, the statement should show (a) the amount of the bonus or other payment made for the right to operate the mine; (b) the period covered by the lease, and the estimated quantity of units in the mine when the lease contract was entered into. 544

In addition to the deduction hereinbefore provided for, the operator will be permitted to deduct from the gross income of each year a reasonable allowance for depreciation of all physical property used in connection with the operation of the mine, and owned by the operator. For this purpose the actual cost (not value) will be equitably distributed over the useful life of such property until the true salvage value has been reached. 545

Both owner and lessee will keep accurate ledger accounts to which will be charged the capital invested in the mine or lease and in machinery, equipment, etc., crediting such accounts or a depletion and depreciation reserve account, with the amount claimed and allowed as a deduction each year until as a result of such credits the capital charge shall be extinguished, after which no further deduction on these accounts will be allowed. 546

RULES FOR TIMBER-OWNING LUMBER COMPANIES.

Art. 173. Corporations owning timber land and logging off the timber and manufacturing it into lumber, will, if the timber was acquired prior to March 1, 1913, be permitted to exclude from gross income either through a deduction from gross receipts or through a charge into the cost of manufacturing the timber into lumber, an amount equivalent to the fair market price or value of the standing timber as of March 1, 1913. 547

- 548 In order to secure the benefit of this deduction such corporations must set up on their books as of March 1, 1913, the fair market price *en bloc*, of all the timber then owned by them, and then, by dividing this *en bloc* value by the estimated number of feet (board measure) in the entire timber holdings, the per unit value or price as of March 1, 1913, will be ascertained, which per unit price or value will be the basis for measuring the amount which may be added to the cost of manufacture, or deducted from gross income, until the *en bloc* value of the entire holding as of March 1, 1913, shall have been extinguished, after which no further deduction on this account shall be allowed.
- 549 The same rule will apply in the case of timber or timber lands purchased subsequent to March 1, 1913, the only difference being that *actual cost*—that is, the gross purchase price—shall, in making the computation, be substituted for *en bloc* price or value as of that date. If the entire market price or value of both timber and lands as of March 1, 1913, or the entire cost, if acquired subsequent to that date, is extinguished through a deduction from gross income for timber used, or through a per unit charge to cost of manufacturing lumber, then the entire amount realized from the logged-off lands or for other salvage will be returned as income of the year in which such lands are sold or disposed of.
- 550 If the timber or timber lands are sold *en bloc*, the gain or loss will be ascertained on the basis of the difference between the fair market price, or cost, and the selling price, according as the property was acquired prior or subsequent to March 1, 1913.
- 551 The fair market price or value of timber or timber lands as of March 1, 1913, is the price at which the property in its then condition, and with the circumstances then surrounding it, could have been sold for cash or its equivalent. This value must not be speculative, but must be determined without taking into account any prospective profits that may result from the manufacture of the timber into lumber. It must be, as the law contemplates, a fair market value and, once determined, must be set up on the books, and, as the measure of a stumpage deduction for income-tax purposes, must remain constant and can not be increased except as new purchases are made at a higher average cost. The value so set up as of March 1, 1913, will be subject to the approval of the Commissioner of Internal Revenue.
- 552 Art. 174. Patents, deduction for return of capital invested therein.—An allowable deduction for any given year for return of capital invested in patents at time of issue will be an amount equal to one-seventeenth of the actual cost, in cash or its equivalent, of such patents. Where the patent has been secured from the Government, its

cost will be represented by the various Government fees, cost of drawings, experimental models, attorneys' fees, etc., actually paid. Where the patent has been purchased for a cash consideration, the amount paid therefor would represent the capital invested therein. If the corporation purchased a patent and made payment therefor in stocks or other securities, the actual cash value of such stocks or other securities at the time of the purchase will represent the cost or capital invested in the patent. If the patent was purchased after a part of its life had expired, the cost for the purpose of a deduction for return of capital will be ratably spread over the remaining years of its life. If the patent becomes obsolete prior to its expiration, it will be permissible for the corporation to deduct from gross income such proportion of its original cost (less any amount previously charged off) as the number of years of its remaining life bears to the whole number of years intervening between the date it was acquired and the date it legally expires. In determining the amount deductible on account of the expiring life of patents only the actual cost thereof and not an estimated value as of March 1, 1913, or any other date, will be considered.

Art. 175. Cost of successful drawing, models, etc., capital.—When a 553 corporation has made expenditures for designs, drawings, patterns, or models representing work of an experimental nature and such designs, drawings, patterns, or models prove to be satisfactory and result in the production of salable goods, they will be treated as a capital asset, and the entire cost thereof, including experimental and development expenses, will be capitalized, in which case no part of such expenditures shall be included in expenses of running the business and shall not be treated as a deduction from gross income.

Art. 176. Cost of unsatisfactory models, drawings, etc., a loss.—If, 554 however, the designs, drawings, patterns, or models prove by actual experience to be unsatisfactory and do not result in the production of salable goods and have no asset value, such expenditures when charged off may be included as a loss incident to running the business and as such deducted from gross income, provided that the corporation in taking credit for such expenditures in its income tax return shall make a full and complete explanation with respect to the same and to the satisfaction of the Commissioner of Internal Revenue.

Art. 177. Obsolescence of models, drawings, etc., deductible as a loss.—555 If designs, drawings, patterns, or models result in the production of goods which prove to be salable for a certain length of time and then become obsolete and can not be sold, the amount expended for such designs, drawings, patterns, or models, less any amounts previously claimed as depreciation with respect to the same or as a re-

turn of capital, may when charged off, be included in, and deducted as a loss incident to running the business, provided full and complete information is reported in a manner satisfactory to the Commissioner of Internal Revenue.

556 Art. 178. Obsolescence deductible, cost less depreciation and salvage.— Amounts representing losses on account of obsolescence of physical property may be included as a deduction from gross income as a loss, provided such amounts have been recorded in the books following the condemnation and withdrawal from use of the obsolete property. The amount of obsolescence that may be claimed as a deduction shall be ascertained by deducting from the cost of the property the total amount that has been previously claimed and deducted on account of the depreciation of the property, plus the residual value at time of obsolescence, or plus the amount received for the sale of the property. The obsolescence deduction must not include the accumulated depreciation applicable to prior years.

557 Art. 179. Obsolescence when no depreciation is deducted.—If no depreciation has been charged off against such property and deducted from gross income of prior years, the amount allowable as a deduction for the year in which the property becomes obsolete shall be ascertained by deducting from the cost of the property its residual value plus an amount equal to the depreciation actually sustained during the prior period and which might have been deducted when computed at the rate applicable to the same or similar property. The amount of depreciation thus arrived at as applicable to former years may be made the basis of amended returns and a claim for the refund of taxes overpaid by reason of the fact that no depreciation deduction was claimed in those years.

INTEREST.

558 Art. 180. Limit of interest deductions.—Section 12, paragraph "Third," authorizes a domestic corporation having capital stock to deduct from gross income the amount of interest paid within the year (except on indebtedness incurred for the purchase of obligations or securities, the interest upon which is exempt from taxation as income under this title) on its indebtedness to an amount of such indebtedness not in excess of the sum of its entire paid-up capital stock plus one-half of the interest-bearing indebtedness, both outstanding at the close of the year; that is to say, the maximum principal upon which deductible interest may be computed is the amount of paid-up capital stock plus one-half the interest-bearing indebtedness outstanding at the close of the year.

559 Paid or charged as a liability.—The amount of interest thus computed at the contract rate, if actually paid within the year, may be

deducted, or if the accounts of the company are kept on a basis other than actual receipts and disbursements, the amount of interest actually accrued at the contract rate, if computed on an amount not in excess of the maximum principal as hereinbefore indicated, may be deducted, provided it is so entered upon the books as to constitute a liability against the assets, and provided it does not include interest on indebtedness incurred in the purchase of securities, the income from which is not subject to the income tax.

In ascertaining the maximum principal for this purpose, preferred stock will be treated as paid-up capital stock and not as indebtedness.

Art. 181. The full amount of stock as represented by the par value of the shares issued and outstanding is, for the purpose of this title, regarded as the paid-up capital stock, except when such stock is assessable on account of deferred payments or is payable in installments, in which case the amount actually paid on such shares will constitute the actual paid-up capital stock of the corporation.

In cases wherein shares of stock are issued without par or nominal value, "the paid-up capital stock" for the purpose of arriving at the maximum principal will be the amount of cash paid into the corporation or the cash value at the time acquired of the property given in exchange for such stock; that is, the cash or its equivalent in value which the corporation received for the stock issued. (T. D. 1960.)

Where there is no capital stock the entire amount of capital (including interest-bearing indebtedness) employed in the business plus one-half of the interest-bearing indebtedness outstanding at the close of the year constitutes the maximum principal upon which deductible interest can be computed. (T. D. 1960.)

Capital employed in the business, as here used, and as constituting one of the elements in computing an allowable interest deduction, contemplates the entire capital paid in by members of the company, including so much of the accumulated surplus as is actually used or employed in the business and properties of the corporation, but does not include any borrowed capital or interest-bearing indebtedness.

Art. 182. The qualifying phrase "outstanding at the close of the year" is held to apply to paid-up capital stock or capital invested, and interest-bearing indebtedness, which indebtedness, like the paid-up capital stock or capital invested, is required by the law to be reported, in making return of annual net income, as outstanding at the close of the year. From the amount of indebtedness to be so reported there must be eliminated all indebtedness incurred in the purchase of securities the income from which is not subject to the income tax.

The indebtedness hereinbefore referred to, and which is to be reported in the return for the purpose of determining the maximum

principal upon which the interest deduction is to be computed, shall not include noninterest-bearing indebtedness.

- 567 If no indebtedness is outstanding at the close of the year, the maximum deduction allowable on account of interest paid will be the amount of interest paid on an amount of indebtedness (other than indebtedness incurred in the purchase of securities, the income from which is exempt from income tax) not exceeding at any time within the year the entire paid-up capital stock or capital employed in the business outstanding at the close of the taxable year; that is, in such case the paid-up stock or capital invested outstanding at the close of the year measures the highest amount of indebtedness upon which deductible interest can be computed. (T. D. 1960.)
- 568 **Art. 183. Different rates of.**—Interest on bonded or other indebtedness bearing different rates of interest may be deducted from gross income during the year, provided the aggregate amount of such indebtedness on which interest is paid does not exceed the limit prescribed by law and in case the indebtedness is not in excess of the amount on which deductible interest may be legally computed. In such case the indebtedness bearing the highest rate may be first considered in computing the interest deduction, and the balance, if any, will be computed upon the indebtedness bearing the next lower rate actually paid, and so on until interest on the maximum principal allowed has been computed.
- 569 **Art. 184. Property not for sale in the ordinary business.**—Corporations owning property such as office buildings, hotels, apartment houses, etc., which are not for sale in the ordinary business of the corporation, but are held primarily for investment purposes or as a means by which the business of the corporation is carried on, and which are pledged as security for mortgaged notes or bonds upon which interest is paid, can not deduct such interest under the deduction for expense of maintenance and operation, but shall include such interest payments, subject to the limitation of the law, under the regular interest deductions.
- 570 **Art. 185. Preferred stock.**—So-called interest on preferred stock, which is in reality a dividend thereon, can not be deducted in arriving at the net income. For the purpose of the tax, dividends of whatever character can be paid only out of net income, and the net income is subject to the tax, and for this purpose can not be reduced by any distribution among or payment to its stockholders.
- 571 **Art. 186. Interest on indebtedness as rental.**—Interest paid pursuant to contract on an indebtedness secured by mortgage on real estate occupied and used by a corporation, in which real estate the corporation has no equity or to which it is not taking title, is an allowable deduction from gross income as a rental charge, payment of which is required to be made as a condition to the continued use and posses-

sion of the property. If, however, the corporation has an equity in or is purchasing for its own use the real estate upon which such mortgage is a prior lien, the indebtedness will be held to be indebtedness of the corporation within the meaning of the law and the interest paid on such mortgage will be deductible only to the extent that, including interest on other obligations of the corporation, it is within the limit fixed by the law. (T. D. 2090, 1993.)

Art. 187. Interest on capital or surplus.—Interest calculated as being 572 a charge against income on account of capital or surplus invested in the business but which does not represent a payment on an interest-bearing obligation, is not an allowable deduction from gross income—that is to say, the interest which the money would earn if otherwise invested is not a deductible charge against income.

Art. 188. Car-trust certificates.—Equipment or car-trust certificates 573 issued by or for railroad companies are a means by which such companies secure cars or other equipment, or the money with which such equipment is purchased.

The equipment becomes at once an asset of the company and the 574 trust certificates secured by such assets are obligations of the railroad companies, similar to corporate bonds, mortgages, and like obligations. The trustees in whose names legal title to the equipment stands, are not an association within the meaning of this title, and are therefore not a taxable entity, but they are, for the purpose of this title, a fiscal agent, paying off the obligations, both principal and interest, of the railroad companies with funds appropriated by such companies.

The railroad companies may include these trust certificates in the 575 amount of their bonded or other indebtedness reported under item 2 of the return Form 1031, and the interest paid thereon, with interest paid on other obligations, will be deductible, the aggregate amount so deducted not to exceed the limit fixed by law.

If the certificates contain a contract or provision by which the 576 obligor agrees to pay any portion of the tax imposed by this title upon the obligee or reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required to pay, the trustees in such cases, in making interest payments on these certificates, will, in the absence of claims for exemption when interest payments are made to individuals, withhold the normal income tax on such payments regardless of the amount thereof.

Art. 189. Sinking funds invested in bonds of corporation.—If the 577 trustees of a sinking fund established by a corporation have invested the amount of the sinking fund reserve or any portion of it in the bonds of the corporation and such corporation pays to the trustees

the interest on these bonds, such corporation will be permitted to deduct such interest from its gross income, provided the amount of the interest thus paid, plus the interest on any other outstanding indebtedness which it may have, does not exceed the limit fixed by law. The interest paid to the trustees, together with all other earnings on investments made by the trustees of the sinking fund, must be included in the gross income of the corporation. (T. D. 2161.)

- 578 Art. 190. Interest on deposits.—In the case of banks and banking associations, loan or trust companies, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company, may be allowably deducted from the gross income of such corporation.

TAXES.

- 579 Art. 191. Taxes deductible.—Taxes imposed against a corporation by authority of the United States (except income and excess-profits taxes) its territories or any foreign country, or by authority of any State, county, school district, municipality, or other taxing subdivision of a State (not including those assessed against local benefits) and paid within the year for which the return is made, are deductible from the gross income of a domestic corporation.
- 580 Similar taxes with like exceptions, assessed against and paid by a foreign corporation receiving income from any source within the United States, are deductible from its gross income received from such source, except that taxes imposed by a foreign government and paid by a foreign corporation are not deductible from the gross income received by it from sources within the United States. (T. D. 2152.)
- 581 Art. 192. Taxes paid for shareholders.—Banks paying taxes assessed against their stockholders on account of their ownership of the shares of stock issued by such banks can not deduct the amount of taxes so paid in making their returns for the purpose of the income tax imposed by this title unless and to the extent that the laws of the State in which they do business by specific terms make the tax a direct liability of such banks, that is, a lien upon its property. The shares of stock are the property of the stockholders, and to the extent that the taxes assessed on the value of the shares of stock are property taxes the holders are primarily liable for their payment.
- 582 The fact that State laws make it the duty of banks to pay the tax does not necessarily make the tax a liability of the banks. These provisions of State laws are intended only to provide a convenient means whereby the tax assessed against the stock on the basis of its value can be the more readily collected by the tax-collecting officers

and do not attempt to assert liability against the bank, as is evidenced by the fact that in most, if not all, cases the tax is a lien upon the stock. For this purpose the liability of the bank is limited to the duty to collect or withhold from the stockholders the amount of taxes due and to pay the same over to the proper tax-collecting offices. Federal statutes prohibit States from imposing any tax upon national banks except upon the value of their real estate. In cases where States levy a tax on the stock of such banks and make it the duty of the banks to pay such tax for the stockholders such payments are not deductible from the gross income of such banks. (T. D. 2121, 2152.)

This rule applies only to taxes levied upon the value of the capital 583 stock, and it is not intended to so operate as to prevent banking corporations from deducting from their gross income any State tax imposed against the corporation itself on the value of its real estate, furniture and fixtures, or as an excise or a franchise tax; that is, a tax which the corporation is required to pay to the State on account of its own property or business in order that it may transact business within the State is deductible. (T. D. 2152, 2121.)

The rule hereinbefore set out will apply in the case of corpora- 584 tions other than banks, upon the value of whose stock taxes are assessed to the stockholders.

Art. 193. Tax-free bonds.—In the case of bonds or other forms of 585 indebtedness issued with a guaranty that the interest thereon shall be free from taxation as against the holder the corporation paying the tax pursuant to its guaranty, whether Federal, State, or municipal, will not be permitted to deduct the tax so paid. The tax assessable upon this income is a direct liability of the recipient, and the debtor corporation paying it does so voluntarily or at least in pursuance of a contract voluntarily entered into, which contract is in no wise binding upon or to be recognized by the Government in determining the tax liability of the corporation. Hence taxes so paid are not deductible from the gross income of the debtor. (T. D. 2161.)

Art. 194. Local benefits.—So-called "taxes," more properly assess- 586 ments, paid for local benefits, such as street, sidewalk, and other like assessments, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, do not constitute an allowable deduction from gross income. Taxes deductible are those levied for the public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction.

Special assessments, such as are hereinbefore contemplated and 587 which are measured upon the basis of the benefit flowing directly

to the property, are not deductible, even though an incidental benefit may inure to the public welfare. (T. D. 2090.)

- 588 **Art. 195. Import or tariff duties.**—Import or tariff duties levied by act of Congress and paid to the proper customs officers, stamp taxes, and all other taxes (except income and excess profits taxes) imposed by internal-revenue laws and paid to collectors are deductible as taxes imposed under authority of the United States, provided they are not added to and made a part of the cost of articles of merchandise with respect to which they are paid, in which case they will be reflected in the cost of merchandise and can not be separately deducted.

NET INCOME.

- 589 **Art. 196. Act of September 8, 1916, as amended.**—The net income upon which the tax imposed by section 10 of Title I of the act of September 8, 1916, as amended, is levied is that portion of the gross income received from all sources (except from interest on the obligations of the United States or its possessions, or on the obligations of a State or political subdivision thereof) which remains after all authorized deductions have been taken into account.
- 590 **Art. 197. Net income, foreign corporation.**—For the purpose of the tax the net income of foreign corporations shall be ascertained by deducting from the gross amount of income received in this country the deductions enumerated in the act, which deductions shall be limited to expenditures or charges actually incurred in the maintenance and operation of the business transacted and capital invested in the United States or, as to certain charges, such proportion of the aggregate charges as the gross income from business done and capital invested in the United States bears to the aggregate income within and without the United States; that is to say, the deductions from gross income of a foreign corporation doing business in this country or receiving income from sources within the United States, must, as nearly as possible, represent the actual expense and authorized charges incident to the business done and capital invested in this country and must not comprehend, either directly or indirectly, any expenditures or charges incurred in the transaction of business or the investment of capital without the United States. (T. D. 2137, 2161.)

CREDITS.

- 591 **Art. 198. Tax withheld at source.**—In making its return a foreign corporation may take credit against the tax assessable on the basis of the net income so returned for any tax which may have been withheld at the source, provided the income upon which the tax was with-

held is included in the return and provided that the name of the withholding agent is given in the return.

War income tax.—For the purpose of the assessment of the war 592
income tax of 4 per cent the net income of a corporation shall be credited with the amount received as dividends upon the stock or from the net earnings of any other corporation which is taxable upon its net income under this title, and which amount has been included in the gross income.

Art. 199. If a corporation shall have returned as income, interest 593
received on bonds, the interest upon which the debtor corporation had agreed to pay without deduction of income taxes, and if the debtor corporation shall have actually paid the income tax assessable on such interest income, it will be permissible for the corporation receiving such interest to take credit against the tax assessable on the basis of its net income returned, for the amount of tax paid thereon by the debtor corporation.

When the net income has been ascertained in accordance with the 594
rule set out in section 12 (a) of the act of September 8, 1916, as amended by the act of October 3, 1917, the net income so ascertained shall be credited with the amount of excess-profits tax assessed or to be assessed for the same year.

The excess-profits tax assessed or to be assessed is allowed as a 595
credit against the net income for the purpose of the taxes imposed by both the act of September 8, 1916, and the act of October 3, 1917.

WITHHOLDING OF TAX AT SOURCE.

Art. 200. On dividends paid foreign corporations.—Under section 596
13 (f) of the act of September 8, 1916, as amended, dividends upon the capital stock or from the net earnings of domestic or other resident corporations, joint-stock companies or associations, and insurance companies payable to nonresident alien companies, corporations, joint-stock companies or associations, and insurance companies not engaged in business or trade within the United States and not having any office, agent, or place of business therein, shall be subject to a withholding of the tax at the rate of 2 per cent for the year 1916 and thereafter.

When the record owner of such stock is a nonresident alien cor- 597
poration, joint-stock company or association, or insurance company not having an office, agent, or place of business in the United States, the debtor corporation will withhold and pay the tax to the proper officer of the United States authorized to receive it, in manner and form provided for withholding and accounting for tax withheld.

- 598 **Exempt from withholding.**—To enable debtor corporations, joint-stock companies or associations, or insurance companies in the United States, to distinguish between nonresident alien corporations, joint-stock companies or associations, or insurance companies which have and those which do not have any office, agent, or place of business in the United States, and also to enable such nonresident alien corporations, joint-stock companies or associations, or insurance companies as have an office or place of business in the United States, to claim exemption from withholding of the normal income tax on such dividends, a certificate stating that such corporation, joint-stock company or association, or insurance company has an office or place of business in the United States will be filed with the debtor corporation.
- 599 **Art. 201. Actual owner a nonresident corporation.**—The duty of withholding income tax from dividends rests upon domestic or other resident corporations paying the dividend. When it shall be made to appear that the actual owner of its stock is a nonresident alien corporation, it shall be the duty of the debtor or issuing corporation in the United States to withhold the income tax from the amount of dividend it pays to each nonresident alien corporation and to make return of such withholding on monthly return Form 1012. An annual return, which is a summary of such monthly returns, shall be filed on or before March 1 of each year for the preceding calendar year.
- 600 When stock in a domestic or resident alien corporation, whose net income is subject to the normal income tax, is issued in the name of another than a nonresident alien corporation, the dividends on such stock will not be subject to withholding of the normal tax under the provisions of section 13 (*f*), except when the debtor corporation or its withholding agent has knowledge that the actual owner of the stock is a nonresident alien corporation, subject to withholding.
- 601 **Record owner liable to tax.**—In all cases where the actual owner of stock is a nonresident alien corporation and the record owner is an individual, firm, or corporation in the United States, citizen, or resident alien, and the actual ownership has been disclosed, the record owner will be held for income-tax purposes to have the receipt, custody, control, and disposal of the dividend and will be required to make return for the actual owner and pay the tax found by such return to be due.
- 602 **Credit for tax withheld.**—If for any reason there is included in the return which a foreign corporation is required to make of all income received from sources within the United States any income upon which tax has been withheld at the source, such foreign corporation may take credit against the amount of tax due for the amount of the tax so withheld at the source; provided a statement is attached

to the return setting forth the source and amount of the income upon which the tax was so withheld.

Art. 202. Under section 13 (e) of the act of September 8, 1916, as 603 amended by the act of October 3, 1917, interest on bonds of domestic corporations, joint stock companies or associations, and insurance companies, payable to nonresident alien corporations, is subject to deduction of tax at the source at the rate of 6 per cent (2 per cent under the act of Sept. 8, 1916, and 4 per cent under the act of Oct. 3, 1917). Foreign corporations will file ownership certificate Form 1000 in presenting coupons for payment. If a foreign corporation has an office, agent, or place of business in the United States, certificate Form 1001 shall be filed establishing such fact and relieving the corporation from deduction of the tax at the source.

Interest on corporate bonds.—If a foreign corporation having no 604 office, agent, or place of business in the United States receives income from sources within this country, other than that upon which the tax has been withheld at the source, it shall make a return of annual net income to the collector of internal revenue at Baltimore, Md., accounting for therein all the income received during the year from all sources in the United States, including that upon which the tax has been withheld, taking credit for the amount of the tax so withheld at the source under the conditions hereinbefore set out.

Nothing in the foregoing provisions shall be construed to relieve 605 a foreign corporation having income from sources within the United States from making a return of annual net income.

RETURNS.

Art. 203. When required.—Every corporation not specifically enu- 606 merated as exempt shall make a return of annual net income whether or not it may have for the particular year any net income, or whether or not it shall be a subsidiary of or controlled by another corporation, and such return, if made on the basis of a calendar year, must be filed with the collector on or before March 1, next following the year for which the return is made; if on the basis of a fiscal year ending with a date other than December 31, it must be filed within 60 days after the close of such fiscal year.

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Dissolved corporations to make final return.—All corporations hav- 608 ing an existence as such during all or any portion of a year, unless coming within the class specifically enumerated as exempt, are required to make returns. Corporations dissolved during the year and whose fiscal year coincides with the calendar year will make returns covering the period from January 1, to the date of dissolution, and

such corporations having a fiscal year other than the calendar year, will make returns covering the period from the beginning of the fiscal year to the date of dissolution, and new corporations will make returns for the period from the date of organization to December 31, unless a fiscal year is designated in the proper manner, in which case returns for a period from the date of organization to the close of the fiscal year so established, in no case to exceed 12 months, will be filed.

- 609 **New corporation.**—A new corporation making a return for a properly established fiscal period less than 12 months, but embracing parts of two calendar years, must file its return within 60 days from the last day of the designated fiscal year.
- 610 **In the absence of notice, fiscal year returns not acceptable.**—A return made on the basis of a fiscal year other than the calendar year can not be accepted, unless such fiscal year shall have been established by proper notice to the collector of internal revenue of the district in which such corporation has its principal place of business (T. D. 2090, 2152, 2137), and if in the absence of such notice and designation a return is filed subsequent to the date when it was required to be filed if made on a calendar-year basis, it will be considered delinquent and the corporation will be liable to the penalty imposed for failure to file the return within the prescribed time.
- 611 **Art. 204. Date of filing and execution.**—In all cases where a fiscal year is not established as above prescribed, returns must be made on the basis of the calendar year, in which case such returns must be filed on or before the 1st day of March next succeeding such calendar year. Such returns in either case provided must be verified under oath or affirmation of its president or other principal officer, and its treasurer or assistant treasurer; that is to say, by two different persons acting in the official capacity indicated.
- 612 **Art 205. Liquidating corporations.**—A corporation going into liquidation during any tax period may, at the time of such liquidation, prepare a "final return" covering the income received or accrued to it during the fractional part of the year during which it was engaged in business, and immediately file the same with the collector of the district in which the corporation has its principal place of business. Before distributing its assets, a dissolving corporation should reserve funds sufficient to pay any income tax assessable against it. Otherwise the tax may be collected by suit against the stockholders. (T. D. 2209, 2090.)
- 613 **Art. 206. Change of corporate name.**—A mere change in name does not constitute a new corporation. If the business was continuous throughout the year, no change in management or operation other than the change in name having occurred, the return should be made covering the business transacted throughout the year, such return

to be made by the corporation in the name which it bears at the end of the year, with a notation on the return to the effect that the name had been changed, giving both the old and the new names. If, however, a distinctly new corporation was organized to take over the property of the old, both corporations will be required to make separate returns covering the periods of the year during which they were respectively in charge of the business. (T. D. 2137.)

Art. 207. Branch corporations.—For the purpose of the tax and for **614** the purpose of a return, every corporation is held to be and is a separate and distinct entity. The fact that a branch corporation is organized in any State to meet peculiar conditions there existing and which make it impracticable for the parent company as such to do business in such State, although such subsidiary may be to all intents and purposes a mere branch of the parent company, does not relieve it from the necessity of making a return for each year.

If such branch corporation actually transacts business from which **615** income arises, accrues, and is received by it, it will be incumbent upon such corporation to make a detailed return, as if it were in no way related to any other corporation, setting forth in such return the full amount of income which it receives or which accrues to it, together with the authorized deductions therefrom, and upon any net income thus disclosed the tax will be assessed and required to be paid.

Income of subsidiary paid to parent taxable as dividends.—If the net **616** income upon which the tax has been levied and is payable is turned over to the parent company, the holder of its stock, the amount so turned over will be held to be dividends, or amounts paid to it out of net earnings and must be returned by the parent company for the purpose of the 2 per cent tax imposed by the act of September 8, 1916, but for the purpose of the war income tax imposed by Title II of the act of October 3, 1917, the net income of the parent company may be reduced by the amount of dividends so received.

Art. 208. Subsidiaries operated as integral parts.—If subsidiary cor- **617** porations exist in name only, or are mere agents or integral parts of the parent corporation and as such transact no business and have no income of and for their own account, and incur no expenses, all business being transacted, all income being received and all expenses being paid directly by the parent company, no separate accounts being kept by or for such subsidiaries, it will be considered that such subsidiary concerns do not have any taxable income within the meaning of this title, and so long as they are so operated no tax liability will be asserted against them.

Subsidiaries to make returns.—In such cases, however, such sub- **618** sidiary corporations will be required to make returns of annual net

income, and shall indorse thereon a statement to the effect that the corporation making the return is a subsidiary or integral part of the parent company (naming it) and that, for its own account, it has no income from any source whatever, that it makes no disbursements, and that all the business done in its name is done for the account of and is the business of the parent corporation, and will be accounted for in the return of such parent corporation.

619 **Branches having income on their own account.**—This ruling is not intended to cover those subsidiary corporations which actually transact business in their own names, receive income for their own account, which incur and pay expenses incident to the production of such income, which keep separate books of account, and which, as separate entities, exercise all the powers and functions authorized by their charters. Corporations of the latter character will be required to pay the income tax on the net income received by them from all sources, regardless of the fact that such net income is paid or turned over to a parent or holding company, by whom it must also be returned for the purpose of the tax imposed by section 10 of the act of September 8, 1916.

620 In the latter case it is held that both the parent and subsidiary companies must make separate returns. (T. D. 2090, 2137, 2161.)

621 **Art. 209. Receivers to make returns.**—Section 13, paragraph C, of this title requires receivers, trustees in bankruptcy, or assignees, who are in charge of and are operating the property and business of corporations, to make returns of annual net income and pay any income tax thereby shown to be due, regardless of what disposition, subject to the orders of the court, may be made of such income.

622 Notwithstanding the fact that the powers and functions of the corporation are suspended and that the property and business are for the time in control and custody of the receiver, trustee, or assignee, subject to the orders of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required for the purpose of this title to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. The income which he receives on account of the business transacted is the income of the corporation and, no matter how such income is applied, it is subject to the tax imposed by this title in so far as it exceeds the deductions or allowances authorized by law.

623 The receiver, trustee, or assignee acting for the corporation, is required to make a true and accurate return of annual net income covering each year or part of each year during which he is in custody and control of the business or properties and will be liable to all the penalties imposed by this title for failure to meet any of its requirements.

Art. 210. Prescribed forms.—Returns made under this act and pursuant to these instructions must be made on the forms prescribed by this department for each particular year, and which are available at the offices of collectors. 624

Tentative returns.—In the absence of a prescribed form a statement made by a corporation disclosing its gross income and deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time a return so made will relieve the corporation from liability to the penalties imposed by law, provided that upon request and without delay such tentative return be substituted by a return made on the regular form. (T. D. 2137.) 625

Art. 211. Fiscal year.—Section 13 (a) of this title authorizes corporations desiring to do so to make their returns on the basis of a fiscal year other than the calendar year, provided that 30 days prior to the 1st day of March of the year in which the return would be due if made on a calendar-year basis they file a notice in writing with the collector of internal revenue, designating in such notice the last day of some month (other than December) as the close of their fiscal year. In the case of a corporation which had previously made its return on a calendar-year basis, notice designating a fiscal year having been filed as hereinbefore indicated, such corporation will, on or before March 1 next following the closing date so designated, make a return for the fractional part of the calendar year ended with the date designated as the close of the fiscal year. All returns thereafter must be made for the full fiscal year, and must be filed with the collector on or before the last day of the 60-day period next following the date designated as the close of the fiscal year. For instance, if a corporation made its return for the calendar year ended December 31, 1916, and desires thereafter to make returns as of a fiscal year ended May 31, it may, 30 days prior to March 1, 1918, file a notice in writing with the collector designating May 31 as the close of its fiscal year, whereupon, on or before March 1, 1918, it will make a return for the fractional period from January 1 to May 31, 1917. Thereafter, on or before July 30 (60 days after May 31) of each year, it will make a return for the preceding full fiscal year. 626

Art. 212. New corporation.—In the case of a new corporation, which shall have established a fiscal year in the manner hereinbefore indicated, it may make its first and all subsequent returns on the basis of the year so established, provided that in no case shall a return cover a period greater than 12 calendar months. In the absence of a properly established fiscal year, returns must be made on the calendar-year basis. 627

Art. 213. Change from one fiscal date to another.—In order to change the closing date of the fiscal year from the last day of one month to 628

that of another (other than December) the corporation must at least 30 days prior to the first day of March next following the closing date of the previously established fiscal year file with the collector, in writing, a notice designating the last day of some other month as the close of its fiscal year, in which case a return for the fractional period ending with the date last designated must be made on or before the last day of the 60-day period next following the close of such previously established fiscal year.

629 Art. 214. Must make return for fiscal year.—When a corporation has, in the manner provided by law, established a fiscal year other than the calendar year as the basis for making its return, it is bound by such action to make its returns on such basis until such fiscal year be properly changed. Failing to make its returns on the basis designated and within the prescribed time will subject the corporation to the penalties imposed by this title for delinquency. (T. D. 2001, 2029, 2090, 2137.)

630 Art. 215. If it shall appear in any case that returns have been made to the collector on the basis of a fiscal year not designated as hereinbefore indicated, the corporation making such returns will be advised that such returns can not be accepted, but must be made to cover the business of the calendar year.

631 Art. 216. Forms to be furnished.—Under the authority conferred by this title, forms of return have been prescribed in which the various items specified in the law are to be stated. Blank forms of this return will be forwarded to collectors and should be furnished to every corporation, not expressly exempted, on or before January 1 of each year, in the case of corporations making their returns for the calendar year on or before the first day of the next fiscal year in the case of corporations filing returns for their fiscal year. Failure on the part of any corporation, joint-stock company, association, or insurance company liable to this tax to receive a prescribed blank form will not excuse it from making the return required by law or relieve it from any penalties for failure to make the return within the prescribed time.

632 Failure to receive returns.—Corporations not supplied with the proper forms for making the return should make application therefor to the collector of internal revenue in whose district are located their principal places of business in ample time to have their returns prepared, verified, and filed with the collector on or before the last due date defined by the law and these regulations.

633 Fifty per cent additional tax.—Failure in this respect subjects the corporation to not only 50 per cent additional tax, but to the specific penalty imposed by the law for delinquency. Each corporation should carefully prepare its return so as to fully and clearly set forth the data therein called for. Imperfect or incorrect returns will not be accepted as meeting the requirements of the law.

Art. 217. Change from fiscal to calendar year.—The normal period 634 for which returns are required to be made is the calendar year and the normal due date for filing such return the 1st day of March next following December 31. If a corporation, which had previously established a fiscal year other than the calendar year as the basis for making its return, desires to establish the calendar year basis, it may do so by filing not less than 30 days prior to March 1 next following the closing date of the established fiscal year, a notice in writing with the collector, designating December 31 as the close of its year, in which case it must on or before the 1st day of the March next following file a return covering that period between the closing date of its previously established fiscal year and December 31.

Art. 218. "Last due date."—"Last due date," as used in these regu- 635 lations, is construed to mean the last day upon which a return is required to be filed in accordance with the provisions of the law, or the last day of the period covered by an extension of time granted by the collector or Commissioner of Internal Revenue.

Art. 219. Sunday or holidays.—When the last due date as above 636 defined falls on Sunday or a legal holiday the last due date for filing returns will be held to be the day following such Sunday or legal holiday and the return should be made to the collector not later than such following day, or, if placed in the mails, it should be posted in ample time to reach the collector's office, under ordinary handling of the mails, on or before the date on which the return as here indicated is required to be filed in the office of the collector.

Art. 220. Returns forwarded by mail.—If a return is made and 637 placed in the United States mails in due course, properly addressed, and postage paid, in ample time to reach the office of the collector or deputy collector on or before the last due date, no penalty will be held to attach should the return not be actually received by such officer until subsequent to that date. In cases wherein a question may be raised as to whether or not the return was posted in ample time to reach the collector's office on or before the date due, the envelope in which the return was transmitted should be preserved by the collector of internal revenue and forwarded to the Commissioner of Internal Revenue with the return.

Art. 221. Refusal or neglect to make returns.—In cases wherein cor- 638 porations have neglected or refused to make returns, and in cases wherein returns are found, upon investigation or otherwise, to be false or fraudulent, the commissioner may, upon discovery thereof, at any time within three years after such return is due, make a return upon the information obtained in the manner provided in the act, and the tax so discovered to be due, together with the additional tax prescribed, shall be assessed, and the amount thereof shall be paid immediately upon notice and demand.

- 639** For the purpose of verifying the accuracy of a return, or for making one where none is made, the books of corporations and all other relative data shall be open to the inspection of the Commissioner of Internal Revenue or his duly authorized agents.
- 640** **Art. 222. Extension of time; collector.**—In cases wherein a corporation fails or neglects to file its return within the prescribed time, and such neglect is due to sickness or absence, the collector is authorized to grant an extension of the time within which to file the return, which extension must not exceed 30 days from the normal due date. The application for such extension must be made prior to the expiration of the period for which the extension is desired. Otherwise the return will be considered delinquent and liability to penalty will attach.
- 641** **Art. 223. Absence or sickness.**—Absence or sickness of one or more officers, at the time the return is required to be filed, will not be accepted as a reasonable cause for failure to file the return within the prescribed time, unless it is satisfactorily shown that there were no other principal officers available and sufficiently informed as to the affairs of the corporation to make and verify the return.
- 642** **Art. 224. Commissioner may extend time.**—In meritorious cases the Commissioner of Internal Revenue is authorized to grant a further reasonable extension of time in which returns may be filed, provided the reason for the request therefor is presented fully in writing and is considered good and sufficient.
- 643** **Art. 225. Delay due to reasonable cause.**—In case of any failure to make and file a return within the time prescribed by law, or within the period of extension granted by the collector, the Commissioner of Internal Revenue shall add to the tax 50 per cent thereof, except that where a return is voluntarily filed, after the due date, without notice from the collector, and it is shown that the delinquency was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax.
- 644** **Statement under oath of cause of delay.**—In all such cases the collector will note on the return that the return was voluntarily filed without notice from him, and will procure from the corporation to be forwarded with the return a statement, under oath, setting out in specific terms the cause of the delay, and if such cause is found to be reasonable, that is, a cause which, had the corporation exercised ordinary business care and prudence, would have made it impracticable or impossible to file the return within the prescribed time, the 50 per cent addition will not be made to the tax.
- 645** Exemption from the 50 per cent additional tax will not, however, necessarily relieve the corporation from liability to the specific penalty, viz, a penalty of not to exceed \$10,000.

Art. 226. Inspection of returns; copies of returns.—When the assessments shall have been made the returns shall be filed in the office of the commissioner and shall constitute public records, subject to inspection upon the order of the President, under the rules and regulations prescribed by the Secretary of the Treasury and approved by the President. Copies of returns on file in the commissioner's office are not permitted to be sent to any person, except the corporation itself or to its duly authorized attorney. A duly authorized attorney for this purpose is one possessing a properly executed power of attorney in writing by the corporation, which designation shall be signed by two officers of the corporation and bear the impress of the seal.

Art. 227. Certified copies.—At the request of the Attorney General or a United States district attorney, certified copies of returns may be made by the Commissioner of Internal Revenue and delivered to the United States district attorneys for their use as evidence in the prosecution or defense of suits in which the collection or legality of the income tax assessed on the basis of such returns is involved, or, by special permission of the Secretary of the Treasury, such certified copies of returns may be furnished as evidence in any suit to which the United States Government and the corporation, etc., making the returns are parties, or as evidence before any United States grand jury, and in which, in the opinion of the Attorney General, such certified copies would constitute material evidence. (T. D. 2016.)

Art. 228. Penalty 50 per cent additional.—In section 3176, as incorporated in and made a part of this title, it is provided that—

In case of any failure to make and file a return within the time prescribed by law or by the collector the Commissioner of Internal Revenue shall add to the tax 50 per centum of its amount, except that when a return is voluntarily and without notice from the collector filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to wilful neglect, no such addition shall be made to the tax.

The time "prescribed by the collector" relates to an extension of time, not exceeding 30 days from the normal due date, on or before which the return is required to be filed. That is to say, if upon application by a corporation, an extension of time is granted by the collector the return must be filed on or before the last day of the extended period. Otherwise the 50 per cent tax will be added, subject to the provisions above quoted.

Art. 229. Disclosure of return—Penalty.—The disclosure by a collector, deputy collector, agent, clerk, or other officer or employee of the United States, to any person not legally authorized to receive the same, of any information whatever contained in or set forth by

any return of annual net income made pursuant to this act, is, by the act, made a misdemeanor, and is punishable by a fine not exceeding \$1,000, or by imprisonment not exceeding one year, or both, in the discretion of the court, and if the offender is an officer or employee of the United States he shall be dismissed and be incapable thereafter of holding any office under the United States Government.

COLLECTION AND PAYMENT OF TAX.

- 652 **Art. 230. When payable.**—In the case of returns made on the basis of a calendar year, the corporations against which taxes are assessed shall be notified of the amount thereof on or before June 1 of each successive year, and the taxes shall be paid on or before June 15 of the year in which the assessment is made.
- 653 Corporations making returns on the basis of a fiscal year other than the calendar year shall be notified of the amount assessed against them on or before the last day of the 90-day period next following the date when the return was due, and the taxes shall be paid within 105 days from the due date of the return.
- 654 **Extension of time making return does not extend time of payment.**—Any extension granted by the collector or commissioner of the time within which to file returns will not be construed to correspondingly extend the time for the payment of the tax. If for any reason a return should not be made until the time fixed by law for the payment of the tax has passed, the tax assessed on the basis of such return shall be paid upon notice and demand.
- 655 **Additional assessments.**—In cases wherein additional assessments are made as a result of an examination or audit of the return, the taxpayer shall, immediately following the making of the assessment, be notified of the amount thereof, and such taxes shall be paid within 10 days from the date of such notice.
- 656 **Art. 231. Penalties for failure to pay tax when due.**—Upon failure to pay the tax when due and for 10 days after notice and demand, a penalty of 5 per cent of the amount of tax unpaid and interest at the rate of 1 per cent per month until paid shall be added to the amount of such tax. To the amount assessable on the basis of the net income there shall be added 50 per cent in case of refusal or neglect of a corporation to make return, and 100 per cent in case of a false or fraudulent return, and the corporation so offending shall be liable to a specific penalty not exceeding \$10,000.
- 657 **Art. 232. Penalty for delay and for fraudulent return.**—Any person or officer of any corporation required by law to make, render, sign, or verify any return, who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by

Parts II and III of Title I of the act of September 8, 1916, shall be guilty of a misdemeanor and shall be fined not exceeding \$2,000, or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

Art. 233. Collection of tax due prior to three-year period.—Section 14 658 authorizes the Commissioner of Internal Revenue in cases of refusal or neglect to make returns, or in cases of erroneous, false or fraudulent returns, upon discovery thereof at any time within three years after said returns are due, to make returns upon information obtained and assess the tax thus found to be due against such corporations and collect it in the ordinary statutory method; and section 38, act of August 5, 1909, and section 2, act of October 3, 1913, contain similar provisions. Under this provision, it appears that the commissioner is without authority to make a formal assessment of special excise or income tax unless the liability therefor has been discovered within three years from the date when the return is due. This limitation does not, however, limit the right of the Government to claim and collect, by suit or otherwise, any additional tax found due for a period antedating the three-year limitation.

May be collected by suit.—In numerous cases the courts have held 659 that there is no limitation upon the right of the Government to sue for and recover unpaid taxes. It is not essential that assessment be made; or, if made, that it be made within a specified time. If liability to original or additional tax exists or has been discovered, the amount thereof may be recovered by suit, regardless of the fact that no assessment of the amount has been made, and regardless of the date of its discovery or the period for which the tax is due.

Time for assessment may be waived.—While the Government is fully 660 authorized to recover such taxes by suit, it is desirable, in order to obviate needless expense and annoyance to the taxpayer and the Government, that the collection be made as a result of a formal assessment. In order that this may be done, corporations owing additional taxes for any period antedating the three-year limitation should file amended returns, together with a statement formally waiving the three-year statutory limitation and consenting to assessment. In executing such amended returns or waivers, the corporations forfeit none of their rights under the law, and no penalty is incurred which might not be otherwise enforced by suit.

Art. 234. Past due taxes voluntarily paid.—If the corporation against 661 which additional tax liability is discovered will formally accept the findings of the examining officer and agree to voluntarily pay the additional tax to the collector of internal revenue and does so pay the additional tax, amended returns or waivers will not be required.

MISCELLANEOUS PROVISIONS UNDER THE ACT OF OCTOBER 3, 1917.

662 Art. 235. Fiscal year ending during 1916.—Section 25 provides:

That income on which has been assessed the tax imposed by Section II of the act entitled "An act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October third, nineteen hundred and thirteen, shall not be considered as income within the meaning of this title: *Provided*, That this section shall not conflict with that portion of section ten, of this title, under which a taxpayer has fixed its own fiscal year.

663 This provision is intended to exclude from taxable income under this title, any income received after January 1, 1916, which, in returns for periods prior to that date, has been accounted for on an accrual basis, and upon which the tax has been assessed and paid; that is to say, any income returned upon which the tax imposed by the act of October 3, 1913, had been assessed though actually received subsequent to January 1, 1916, is not subject to the tax imposed by this title.

664 Art. 236. Life insurance premiums not deductible.—Section 32 of the act of September 8, 1916, specifically provides that premiums paid by corporations for insurance covering the lives of officers, employees, or those financially interested in the trade or business of such corporations, shall not be deducted from the gross income of the corporations paying the same. This provision is held to apply to all forms of life insurance, the premiums upon which the corporations may pay, whether or not the corporations are the beneficiaries of the insurance policies upon the death of the insured, and all rules and regulations in conflict with this article are hereby revoked.

665 Art. 237. Return covering dividends paid.—Under the provisions of section 26 of the act of September 8, 1916, as amended, every corporation subject to the tax imposed by this title shall, when required so to do by the Commissioner of Internal Revenue, render a correct return under oath, in which is set out the amount of dividends paid by it during the year covered by the return, whether paid in cash or its equivalent in stock; the names and addresses of its stockholders, the number of shares owned by each, the tax years in which the amounts distributed were earned, and the amounts so distributed to each stockholder, applicable to the earnings of each of such years.

666 This return, when required, will be made upon a form prescribed for this purpose, and will be forwarded direct to the office of the Commissioner of Internal Revenue within 10 days from the date of the receipt of the notice requiring such return.

667 Art. 238. Section 10 (b) of the act of September 8, 1916, as amended by the act of October 3, 1917, provides that there shall be levied, assessed, collected, and paid a tax of 10 per cent upon the amount remaining undistributed six months after the end of each calendar or fiscal year of the total net income of every corporation,

joint-stock company or association, or insurance company, but this tax shall not apply to that portion of such undistributed net income invested or employed in the business or retained for employment in the reasonable requirements of the business or invested in the obligations of the United States issued after September 1, 1917.

In order to determine the amount of such net income subject to this 668 tax, the increase in the surplus balance at the close of the taxable year as compared with the surplus balance at the beginning of such year, shall be analyzed so as to account for the disposition thereof in increase in assets, decrease in liabilities or in dividends, and the net increase in current assets over current liabilities shall be subject to the above tax of 10 per cent unless it can be conclusively shown by the corporation that such increase is retained to provide for an actual increase in business or for additions to plant or the reduction of bonded or other fixed liabilities.

INSURANCE COMPANIES.

Art. 239. Tax liability.—Under the provisions of Title I of the 669 act October 3, 1917, a tax of 4 per cent in addition to the tax of 2 per cent is imposed upon the net incomes of foreign and domestic insurance companies operating in the United States (with the exception of Porto Rico and the Philippine Islands), determined in accordance with the conditions prescribed in the act September 8, 1916, except that dividends received from other corporations subject to the income tax are not subject to the 4 per cent war-income tax.

Net income, how ascertained.—For this purpose the net income of 670 an insurance company is to be ascertained (with the exceptions herein-after noted) in the same manner as directed by the terms of the income-tax law approved September 8, 1916, except that for the purpose of the 4 per cent war-income tax, a credit against the net income is permitted, representing the amount of dividends received upon the stock or from the net earnings of any other corporation, joint-stock company or association, or insurance company, which is taxable upon its net income under this title.

Returns to conform to State reports.—Returns of insurance com- 671 panies must be rendered in conformity with reports made for the same period to the State insurance departments. As all insurance companies are required by law to render their reports to the various State insurance departments for the calendar year, their returns of annual net income for the purpose of the income tax should be made for the same period, unless their books are actually kept on a fiscal-year basis.

Treasury Decision 2433, providing that returns may be made on a 672 basis other than as above set forth, is not applicable to insurance companies.

- 673 Gross income.**—Gross income of insurance companies consists of the total revenue derived from the operation of the business, including income, gains, or profits from all other sources within the calendar year for which the return is made, except as modified by the special provisions of law which apply to insurance companies.
- 674 Gross income,** as defined above, will include net premiums, investment income, income from the sale of capital assets, all gains, profits, and income as reported to the State insurance departments, except the items specifically exempted in the act, as construed by these regulations.
- 675 Exempted income.**—There is specifically exempted from taxation interest received on obligations of the United States or its possessions, or on the obligations of a State or any political subdivision thereof. Therefore, in ascertaining gross income for the purposes of the tax, all interest received from such sources should be eliminated. (Report to State, schedule D, parts 1 and 4.) As accrued interest on bonds purchased is not included in the interest income reported to the State insurance department, it must not be included in the amount eliminated from gross income in the return. (Report to State, schedule D, part 3.) In the case of obligations of the United States issued after September 1, 1917, income from such obligations is exempt from tax only to the extent provided in the act authorizing their issue. Income from such obligations received by insurance companies is exempt from the 2 per cent and 4 per cent income tax.
- 676 Copy of report to State.**—As an assistance in auditing the returns, wherever possible, a copy of the report to the State insurance department should be submitted with the returns; otherwise schedule D, parts 1, 3, and 4, of the report should be attached thereto showing Federal, State, and municipal obligations from which the interest omitted from gross income was derived.
- 677 Amounts representing reinsurance treaties** will be eliminated from income and disbursements.
- 678 Deposit premiums on perpetual risks** received and returned should be treated in the same manner, as no reserve will be considered covering liability for such deposits, but the earnings on such deposits will be included in the premium income.
- 679 Sale of capital assets.**—For the purpose of ascertaining the gain or loss from sale or other disposition of ledger assets acquired prior to March 1, 1913, the fair market price or value of such assets as of March 1, 1913, shall be the basis for determining the amount of such gain or loss to be accounted for in the return of the year in which the assets are sold. If acquired subsequent to March 1, 1913, then the profit or loss to be returned or claimed will be the difference between the cost and the selling price.

Reinsurance and return premiums should not be included in gross 680 income nor in deductions.

Exempted organizations.—There are exempted under the provisions 681 of the act fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and providing for the payment of life, sick, accident, or other benefits to the members of such societies, orders, or associations or their dependents; and farmers' and other mutual hail, cyclone, or fire insurance companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses.

Lodge system.—A society or association "operating under the lodge 682 system" is considered to be one organized under a charter, with properly appointed or elected officers, with an adopted ritual or ceremonial, holding meetings at stated intervals, and supported by fees, dues, or assessments.

Affidavit required.—It is not sufficient that companies of the fore- 683 going classes merely claim exemption, but it must be shown by affidavit or otherwise to the satisfaction of the Commissioner of Internal Revenue that the conditions set forth in the exempting provisions have been fully met.

In ascertaining the net income of an insurance company, for the 684 purpose of the tax imposed by this title, the general provisions contained in the law and elsewhere in these regulations will be observed, except as modified by specific legislation or regulations concerning insurance companies.

DEDUCTIONS.

Art. 240. The following deductions from gross income will be 685 allowed in returns made by insurance companies other than mutuals, but including mutual life and mutual marine.

All ordinary and necessary expenses paid within the year in the 686 maintenance and operation of the company and its properties.

Interest.—Interest paid on indebtedness wholly secured by prop- 687 erty collateral the subject of sale or hypothecation in the ordinary business of the company as a dealer only in the property constituting such collateral or in the loaning of funds thereby produced is an allowable deduction as a business expense to an amount of the interest paid on such indebtedness not in excess of the actual value of the collateral securing it.

Incidental repairs.—Expenditures for incidental repairs which do 688 not add to the value nor appreciably prolong the life of property are deductible as expenses, but expenditures for new buildings, per-

manent improvements, or betterments which increase the value of property, or for restoring or replacing property, are not deductible under this or any other item of the return. Such expenditures are properly chargeable to capital account, to be extinguished through annual depreciation allowances.

- 689 **Cost of furniture.**—Insurance companies will be permitted to add to expenses, in lieu of depreciation of furniture and fixtures, the actual cost of repairs, replacements, and renewals of such furniture as is reported to the State insurance department. Provided that in case of an original investment the cost thereof shall be charged to capital account.
- 690 **Premiums paid.**—Premiums paid on life insurance policies covering the lives of officers, employees, or those financially interested in any trade or business conducted by an individual, partnership, corporation, joint-stock company or association, or insurance company, shall not be deducted in computing the net income of insurance companies.
- 691 **Losses actually sustained.**—Losses deductible (other than policy payments) must be distinguished from depreciation or allowances for exhaustion, wear and tear. The losses must be absolute, complete, actually sustained during the year, and charged off on the books of the company, and if the losses result from the sale of assets acquired prior to March 1, 1913, such losses shall be ascertained by taking the difference between the fair market price or value as of March 1, 1913, and the selling price. If the assets were acquired subsequent to March 1, 1913, the loss will be the amount by which the selling price is less than the *cost*.
- 692 **Losses compensated by insurance or otherwise** are not deductible.
- 693 **Agency balances.**—There may also be deducted losses from agency balances or other amounts charged off as worthless, and losses by defalcation, premium notes voided by lapse, provided such notes have at some time been included in gross income for income tax purposes; otherwise, they will not be deductible.
- 694 **Policy losses.**—As payments on policies there should be reported all death, disability, or other policy claims (other than dividends) paid within the year, including fire, accident, and liability losses, matured endowments, annuities, payments on installment policies, surrender values, and all claims actually paid under the terms of policy contracts.
- 695 **Net addition to reserve funds.**—*All policy premiums, on which net addition to reserve is computed, must be included in gross income.* The net addition may be based upon the highest authorized reserve by the statutes of any States in which the company does business. When the reserve at the end of the year is less than at the beginning of the year there is a "released reserve," and the amount so released must

be included in gross income. In the case of assessment insurance companies, whether domestic or foreign, the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guaranty or reserve funds shall be treated as being payments required by law to reserve funds. In the case of life insurance companies, the net addition to the "reinsurance reserve" and the "reserve for supplementary contracts," and in the case of fire, marine, accident, liability, and other insurance companies, the net addition to the "unearned-premium reserves," and only such other reserves as are specifically required by the statutes of the States within which the company is doing business will be allowed as deductions.

Taxes paid for stockholders.—Taxes paid by companies on the value 696 of their capital stock outstanding and in the hands of stockholders are not deductible. Such taxes are a primary liability of the stockholders and therefore chargeable against their (the stockholders') income.

Dividends from foreign corporations.—Insurance companies claiming 697 as a deduction from gross income, for the purpose of the 4 per cent war income tax, dividends received from foreign organizations must accompany their returns by a list giving the names of such organizations and the amount received from each.

LIFE INSURANCE COMPANIES.

Art. 241. Surrender values.—Gross income of life insurance com- 698 panies should include, in addition to income heretofore defined, surrender values applied in any manner, consideration for supplementary contracts involving and not involving life contingencies, and all other income, gains or profits.

Applied surrender values and consideration for supplementary 699 contracts, not involving life contingencies included in income, will, of course, be deducted as payments under policy contracts; but for convenience in verifying the returns these items should appear in the return in both gross income and deductions.

Premium income paid back.—Life insurance companies are author- 700 ized to omit from gross income such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to the policyholder or treated as an abatement of his premium.

The amount authorized by this provision to be excluded from gross 701 premium income on account of any premium refunded to any individual policyholder is explicitly limited to an amount not in excess of the actual premium paid by the individual policyholder within the tax year.

Cash dividends.—Life insurance companies are entitled under the 702 foregoing holding to exclude from gross income any part of the pre-

mium received which is paid back to the individual policyholder within the same return year. Where the dividend is in excess of the premium received, there can be excluded from gross income only the amount of the premium received from such individual policyholder within the same return year.

- 703 **Dividends provisionally ascertained.**—Dividends provisionally ascertained, apportioned, or credited on deferred dividend policies can not be excluded or deducted from gross income for the reason that the assured has no vested or enforceable right in them and can not, at the time of the ascertainment, apportionment, or credit, nor until the maturity of the policy, avail himself of such dividends; and in the event of the death of the assured prior to the expiration of the deferred dividend period, the amount so ascertained, apportioned, or credited lapses.

MUTUAL INSURANCE COMPANIES OTHER THAN MUTUAL LIFE AND MUTUAL MARINE.

- 704 **Art. 242.** The act of September 8, 1916, provides:

That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, *but shall return as taxable income all income received by them from all other sources plus* such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves.

- 705 The foregoing provision is construed to embrace all mutual insurance companies (other than mutual life and mutual marine and companies exempt); interinsurance and reciprocal exchanges and returns of annual net income should be made on the special form (No. 1030A) provided for that purpose.
- 706 **Gross income.**—Gross income of such companies will consist of the total revenue derived from the operation of the business but *excluding* all income received from premiums, assessments, fees, and other amounts paid by the policyholders necessary to secure or continue the policy in force. If, however, any portion of the funds thus received is retained or finally used for any purpose other than the payment of losses, expenses, or reinsurance reserves, such portion is, by the terms of the law, taxable and must be returned as income.
- 707 **Rent income.**—All payments received in cash or its equivalent, as rent on buildings or other property owned or controlled by the company making the return, must be returned as taxable income, after deducting the amount paid for repairs and expenses, including taxes

(levied for purposes other than local benefits) *as has been expended on the property from which the rental income returned was derived.*

Sale of capital assets.—The profit or income to be returned in the 708 event of the sale or maturity of capital assets acquired prior to March 1, 1913, should be determined upon the basis of the difference between the fair market value of such assets as of that date and the selling price thereof. If the assets were acquired subsequent to March 1, 1913, the loss will be the amount by which the selling price is less than the *cost*. This profit or income may, for the purpose of the tax, be reduced by the amount of any loss resulting from the same source and ascertained in the same manner. In no event can a loss resulting from the sale or maturity of capital assets exceed the gain within the year from like transactions.

Other income.—All other income or earnings not hereinbefore re- 709 ferred to will form a part of and must be reported as taxable income.

MUTUAL MARINE INSURANCE COMPANIES.

Art. 243. Premiums repaid and interest.—Mutual marine insurance 710 companies may include in their deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the date of ascertainment thereof and the date of payment thereof, such amounts and interest having been included in gross income, which amounts deducted from gross income should be fully set forth in the supplementary statement of the return form.

FOREIGN INSURANCE COMPANIES.

Art. 244. Foreign insurance companies.—Insurance companies or- 711 ganized, authorized, or existing under the laws of any foreign government shall report as gross income the gross amount received within the year from all sources within the United States or its possessions. Income from business transacted by a United States branch or agency of a foreign insurance company which relates to a foreign country must be returned as gross income. Otherwise articles applicable to insurance companies in general will be followed as to income and deductions.

Income from investment.—Insurance companies organized, author- 712 ized, or existing under the laws of any foreign government, not transacting an insurance business in the United States or its possessions but receiving income from investments therein must make returns of such income, deducting therefrom the amount of such income withheld at the source.

ASSESSMENT LIFE AND ACCIDENT INSURANCE COMPANIES; STOCK FIRE INSURANCE COMPANIES; STOCK CASUALTY, FIDELITY, AND SURETY INSURANCE COMPANIES; MISCELLANEOUS STOCK COMPANIES.

- 713 Art. 245.** Companies of the foregoing classes will make their returns in accordance with articles applicable to insurance companies in general.
- 714 Art. 246.** Except as otherwise specially provided in the law or in these regulations, the general regulations hereinbefore provided for the use of corporations, joint-stock companies, or associations will be observed by insurance companies in making their returns.

CLAIMS.

REFUND OR ABATEMENT OF INCOME TAX.

- 715 Art. 247. Section 3218, Revised Statutes.**—Every collector shall be charged with the whole amount of taxes, whether contained in lists transmitted to him by the Commissioner of Internal Revenue or by other collectors, or delivered to him by his predecessor in office, and with the additions thereto, * * *, and with all moneys collected for penalties, forfeitures, fees, or costs; and he shall be credited with all payments into the Treasury made as provided by law, * * *, and with the amount of taxes contained in the lists transmitted, in the manner heretofore provided, to other collectors, and by them receipted as aforesaid; also with the amount of the taxes of such persons as may have absconded or become insolvent prior to the day when the tax ought, according to the provisions of law, to have been collected, and with all uncollected taxes transferred by him, or by his deputy acting as collector, to his successor in office: *Provided*, That it shall be proved to the satisfaction of the Commissioner of Internal Revenue, who shall certify the facts to the (First) Comptroller of the Treasury, that due diligence was used by the collector. And each collector shall also be credited with the amount of all property purchased by him for the use of the United States, provided he faithfully account for and pay over the proceeds thereof upon a resale of the same, as required by law.

CREDIT TO COLLECTORS FOR TAXES CHARGES AGAINST THEM WHICH ARE UNCOLLECTIBLE.

- 716 Art. 248.** Collectors are entitled to credit for taxes assessed against parties who may have absconded or become insolvent prior to the day when the tax ought, according to the provisions of the law, to have been collected: *Provided*, That it shall be proved to the satisfaction of the Commissioner of Internal Revenue, who shall certify

the fact to the Auditor for the Treasury Department, that due diligence was used by the collector.

It should be borne in mind that, though credits allowed on account of insolvency or absconding release the collector from the obligation created by his receipt for the amount credited, the obligation to pay still remains upon the parties assessed. Collectors should therefore keep a record (No. 23) of all taxes thus credited and of the persons from whom they are due, and should enforce payment whenever it is in their power to do so. 717

If a tax reported as uncollectible on account of the insolvency or absconding of the party owing it is paid after credit has been given for it, it should be returned upon Form 53. 718

PREPARATION OF CLAIMS FOR CREDIT FOR TAXES AND ASSESSED PENALTIES ALLEGED TO BE UNCOLLECTIBLE.

Form 53.

Art. 249. When a tax is found to be uncollectible the collector or deputy collector who made the demand for payment and is conversant with the facts should prepare a claim on Form 53, showing the name and address of the party assessed, the article or occupation for and on account of which the assessment was made, the list, page, and line on which assessed, the amount claimed, the date of first demand, and the date when the tax was found to be uncollectible, and the cause of inability to collect. The amount or amounts claimed should be entered on the Form 53 under the respective column in which it or they are charged to the collector on Form 23. One or more claims, covering taxes of the same nature, may be entered upon one Form 53, and in cases where a tax and a penalty are both claimed to be uncollectible but one entry of the name, address, etc., should be made, but the amounts should be entered in their respective columns. 719

Collectors are required to make demand within the time prescribed by law, and either to collect the taxes or prove them to be uncollectible, within six weeks after the receipt of the list, unless special reasons are furnished, such as lack of mail facilities, great extent of territory, etc., showing why they could not be collected within that time. 720

Six months are allowed from the receipt of a list in which to close it up, either by collection or by presenting claims for abatement; but when an abatement of taxes alleged to be uncollectible is asked, it must be shown in the vouchers, by dates, or otherwise, that they could not have been collected at the time they first became due and payable according to law, nor at any time since. Where dates can not be 721

given, it should appear in each case that they were uncollectible before distraint was or could have been made.

- 722 When it happens that a tax has been paid for which a claim on Form 53 has been filed and is pending, the collector should at once notify the department of such payment.
- 723 When the claims have been thus prepared they should be carefully sealed up and mailed to the Commissioner of Internal Revenue, marked "Income Tax Division." Letters of transmittal should not be sent with claims unless they contain necessary explanations.
- 724 The Form 53 should show when the tax first became due; whether the taxpayer had any property liable to distraint at that time or thereafter; and whether the collector used due diligence at all times to collect the tax.
- 725 It is the duty of the collector to use the same diligence to collect a tax after it has been abated as uncollectible, or as in suit, as before abatement. Such an abatement does not impair the claim of the Government against the taxpayer.

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TAXES THAT ARE OR HAVE BEEN IN LITIGATION.

- 726 Art. 250. No suit will be brought for the recovery of unpaid internal-revenue taxes until the collector of the district shall have submitted to the Commissioner of Internal Revenue a full report of all material facts and circumstances with the case, and shall have received from him express authority to report the case to the United States attorney for suit.
- 727 Art. 251. Amounts collected by distraint or otherwise, subsequent to the institution of the suit, should be at once reported to the United States attorney for his guidance in his further prosecution of the case in court.
- 728 Art. 252. Credit given the collector for taxes abated as uncollectible will not affect a suit pending for their recovery, nor will it relieve the collector from the duty of distraining any property of the taxpayer that may be found at any time before judgment.
- 729 Art. 253. When a suit for the recovery of a tax is decided in favor of the United States, and execution issued and returned *nulla bona*, as respects the whole or a part of the judgment, the collector should satisfy himself by careful inquiry, whether any personal property can be found to satisfy the judgment in whole or in part, and whether there is any real estate which can be subjected, by distraint or by suit in equity, under section 3207, Revised Statutes of the United States, to sale in satisfaction of the judgment; and if he should be fully satisfied that there is no such real or personal property, he should thereupon present to the Commissioner of Internal Revenue a claim, on Form 53, for the abatement of the amount

which has not been and can not be collected, if it has not already been abated, making a statement thereon of his action, accompanied by a certificate of the clerk of the court as to the facts in the case.

Art. 254. When a suit for taxes not abated as uncollectible is dismissed upon a technical defeat in the proceedings, or when an adverse verdict is rendered on some technical ground not reaching the merits of the case, and the right to a new trial or to an appeal has lapsed, and the tax can not be collected by distraint or by suit in equity to subject real estate to sale, the claim for abatement of the taxes should be made on Form 53. 730

Art. 255. Collectors are authorized to pay the clerk of the court his legal fees for the certificates required by the regulations of this department furnished by him relative to litigated taxes, and will be credited in their expense accounts for the amounts so paid on filing therewith vouchers covering the expenses thus incurred. (See Regs. No. 2, p. 84.) 731

Art. 256. Where land is sold to satisfy assessments the amount realized, after deducting expenses of sale, should be credited to the lists, and the remainder, if uncollectible, claimed on Form 53. If land is bid in by the collector for the United States, the amount for which the same is purchased, after deducting expenses of sale, should be credited to the assessments under the limitations prescribed in Regulations No. 2, revised, and the remainder, if uncollectible, claimed on Form 53. 732

PREPARATION OF CLAIMS FOR THE ABATEMENT OF TAXES AND PENALTIES ALLEGED TO HAVE BEEN ERRONEOUSLY OR ILLEGALLY ASSESSED OR TO BE ABATABLE UNDER REMEDIAL ACTS.

Art. 257. Section 3220.—The Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized, on appeal to him made, to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected; also to repay to any collector or deputy collector the full amount of such sums of money as may be recovered against him in any court, for any internal taxes collected by him, with the cost and expenses of suit; also all damages and costs recovered against any assessor, assistant assessor, collector, deputy collector, or inspector, in any suit brought against him by reason of anything done in the due performance of his official duty: *Provided*, That where a second assessment is made in case of a list, statement, or return which in the opinion of the collector or deputy collector was 733

false or fraudulent, or contained any understatement or undervaluation, such assessment shall not be remitted, nor shall taxes collected under such assessment be refunded, or paid back, unless it is proved that said list, statement, or return was not false or fraudulent, and did not contain any understatement or undervaluation.

FORM 47.

- 734 Art. 258.** Claims for the abatement of taxes or penalties erroneously or illegally assessed or which are abatable under remedial acts, etc., must be made out upon Form 47, and must be sustained by the affidavits of the parties against whom the taxes were assessed, or of other parties cognizant of the facts, and must be accompanied by affidavits of the deputy collectors of the divisions in which the claims arise.
- 735** But if the deputy collector has reason to doubt the correctness of the statements made by a claimant he should modify his affidavit accordingly, a space being left for that purpose at the close of the affidavit. If he has not investigated all the facts he should state in the blank space left in the body of the affidavit for that purpose what facts he has not investigated.
- 736** If there are any objections to a claim, the collector should be careful to state them fully in a certificate to be attached to and made part of the claim. In some cases, where the collector has certified to the correctness of claims, the deputy collector makes exceptions to the facts as stated by the claimants. Unless the collector makes a special explanation in every such case, the claim will be returned for such explanation.
- 737** The claim should be still further supported by a certificate of the collector showing the list, page, and line of all assessments therein referred to, not only of the assessment of the tax for the abatement of which the claim is filed, but also of each and every other assessment mentioned in the claim. Even where only a portion of a tax is claimed as erroneous, the collector should be careful to certify the *full amount* assessed.
- 738** When a tax has been assessed and turned over to the collector, the presumption is that the assessment is correct. The burden of proof in rebutting that presumption, and showing that it was improperly or illegally assessed, or that relief should be given under a remedial statute, rests upon the applicant for abatement. The affidavits must, therefore, contain full and explicit statements of all the material facts relating to the claims in support of which they are offered, and which are essential to their proper consideration. Nothing should be left to mere inference, but all the facts relied upon

should appear on the papers themselves. It is only the correctness of the statement of facts to which the deputy collector certifies, not the legality of the claim. The *legality* of the claim is to be determined by the Commissioner of Internal Revenue upon the facts presented and proved by the affidavits.

When a case is compromised, in which an assessment is involved, 739 the amount paid as tax should be credited to the list. The amount, if any, remaining outstanding, should be claimed for abatement on Form 47, if the terms of the compromise so require.

Art. 259. Claims on Form 47 for abatement of errors in assess- 740 ment made in the collector's office, which errors are not corrected by the filing of Form 488, should be executed by the collector, but briefed in the name of the taxpayer against whom the assessment was made.

ALLOWANCE FOR CREDIT OF TAXES ABATED.

When claims for the abatement of taxes, either as uncollectible or 741 erroneous, are allowed in the office of the Commissioner of Internal Revenue, schedule Form 7220 for abatement is drawn for the aggregate of so much as is abated upon each claim named in the schedule. The schedule is sent directly to the collector of internal revenue to whom the taxes are charged, and is his authority for taking credit on Form 51 B and his quarterly account, Form 79, for taxes abated. *No credit for abatements shall be taken except upon schedule Form 7220 from the Commissioner of Internal Revenue.* Orders for abatement are sent to the Auditor for the Treasury Department.

Art. 260. If a collector should discover from the schedule of 742 abated taxes that a mistake has occurred, either in having abated a larger amount than that claimed, or in abating a tax which has been previously abated, he should immediately notify the commissioner of the fact, so that the order may be recalled, and the error be corrected by the issuing of a new one in its place. In such a case no credit, *for any amount whatever*, should be taken upon Form 51 B, or upon the quarterly account until the order of abatement and schedule have been corrected.

FILING OF A CLAIM FOR ABATEMENT DOES NOT OPERATE AS A DELAY OF COLLECTION.

Art. 261. The filing of a claim for the abatement of a tax alleged 743 to have been erroneously assessed does not necessarily operate as a suspension of the collection of the tax, or make it any less the duty of the collector to exercise due diligence to prevent the collection of the tax being jeopardized. He should, if necessary, collect the tax and leave the taxpayer to his remedy by claim on Form 46.

PENALTY OF 5 PER CENT AND INTEREST AT THE RATE OF 1 PER CENT
A MONTH.

744 Art. 262. Section 3184, Revised Statutes.—Where it is not otherwise provided the collector shall in person or by deputy, within 10 days after receiving any list of taxes from the Commissioner of Internal Revenue, give notice to each person liable to pay any taxes stated therein, to be left at his dwelling or usual place of business, or to be sent by mail, stating the amount of such taxes and demanding payment thereof. If such person does not pay the taxes within 10 days after the service or the sending by mail of such notice it shall be the duty of the collector or his deputy to collect the said taxes, with a penalty of 5 per cent additional upon the amount of taxes and interest at the rate of 1 per centum a month.

745 Art. 263. When an assessment is made for a tax or penalty and demand made for payment, if a claim for abatement (Form 47) is filed within 10 days after such demand and accepted by the collector, the amount of the 5 per cent penalty on the tax claimed will wait on the determination of the claim. Upon receipt of the notice of rejection of the claim (or so much thereof as shall not be allowed) the collector should immediately notify the party assessed and demand the payment of the tax; if the tax is not then paid within 10 days after mailing of the notice to the claimant by the collector of the rejection of the claim, the 5 per cent penalty *accrues* on the amount not allowed. If entire amount of assessment is not demanded in claim for abatement and balance of tax is not paid within the required 10 days, the 5 per cent penalty accrues on the balance not claimed. Interest at 1 per cent per month continues to run and should be collected with the tax at the time of payment for the full number of calendar months which intervene between the date of the expiration of the first 10 days' notice and the date of the payment of the tax, notwithstanding the fact that a claim for abatement has been filed.

DUPLICATE CHARGES.

746 Art. 264. Taxes erroneously or illegally assessed are by the Commissioner of Internal Revenue abated to the taxpayer, while taxes uncollectible are simply abated by the commissioner to the collector against whom they are charged; but amounts which by error or otherwise have been twice charged to a collector, are held by the accounting officers to be matters of account, and not subjects for abatement.

747 The collectors shall use Form 488 to adjust the errors in income-tax matters held to be matters of account and not subjects for abatement, and forward the completed form to the Commissioner of Internal Revenue, marked "Income Tax Division."

See Regulations No. 2, article 41, pages 47 and 48, for further information to collectors as to entries to be made in records and accounts. 748

PREPARATION OF CLAIMS FOR THE REFUNDING OF TAXES AND PENALTIES CLAIMED TO HAVE BEEN ERRONEOUSLY OR ILLEGALLY COLLECTED, OR REFUNDABLE UNDER REMEDIAL STATUTES.

FORM 46.

Art. 265. Claims for the refunding of assessed taxes and penalties must be made out upon Form 46. In this case, as in that of claims for abatement upon Form 47, the burden of proof rests upon the claimant. All the facts relied upon in support of the claim should be clearly set forth under oath. The claim should be still further supported by an affidavit of the deputy collector of the proper division, and by the certificate of the collector, showing the list, page and line upon which the assessment appears, the amount of the tax, and the *date of payment thereof*. 749

Collectors and deputy collectors are cautioned that these certificates and affidavits should not be made in a merely perfunctory manner. Claims have been received at the office of the Commissioner of Internal Revenue wherein the statements of the claimant have been certified by the collector and deputy collector as "in all respects just and true," whereas a slight examination of the records of their own offices would have disclosed an entirely different state of facts. 750

Art. 266. A claim for refunding should be made in the name of the party assessed, if living; if he is dead, the claim should be made in the name of the executor or administrator. Certified copies of the letters of administration or letters testamentary, or other similar evidence, should be annexed to the claim to show that the claimant is administrator, etc. 751

The affidavit may be made by an agent of the party assessed; but, in such a case, a power of attorney must accompany the claim. 752

PAYMENT OF CLAIMS ALLOWED.

Art. 267. Warrants in payment of claims allowed will be drawn in the names of the parties entitled to the money, and shall, unless otherwise directed, be sent by the Treasurer of the United States directly to the proper parties or their duly authorized attorneys or agents. But if the claimants are indebted to the United States for taxes, they must be paid before the warrants are delivered. 753

Attention is called to the following act, approved March 3, 1875 (18 Stat. L., 481), concerning— 754

DEDUCTIONS OF AMOUNTS DUE BY CLAIMANTS, ETC.

- 755** Art. 268. *Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That when any final judgment recovered against the United States or other claim, duly allowed by legal authority, shall be presented to the Secretary of the Treasury for payment, and the plaintiff or claimant therein shall be indebted to the United States in any manner, whether as principal or surety, it shall be the duty of the Secretary to withhold payment of an amount of such judgment or claim equal to the debt thus due to the United States; and if such plaintiff or claimant assents to such set-off, and discharges his judgment or an amount thereof equal to said debt or claim, the Secretary shall execute a discharge of the debt due from the plaintiff to the United States. But if such plaintiff denies his indebtedness to the United States, or refuses to consent to the set-off, then the Secretary shall withhold payment of such further amount of such judgment, or claim, as in his opinion will be sufficient to cover all legal charges and costs in prosecuting the debt of the United States to final judgment. And if such debt is not already in suit, it shall be the duty of the Secretary to cause legal proceedings to be immediately commenced to enforce the same, and to cause the same to be prosecuted to final judgment with all reasonable dispatch. And if in such action judgment shall be rendered against the United States, or the amount recovered for debt and costs shall be less than the amount so withheld as before provided, the balance shall then be paid over to such plaintiff by such Secretary, with six per centum interest thereon, for the time it has been withheld from the plaintiff.

STATUTES OF LIMITATION.

- 756** Art. 269. Sec. 3228 (Rev. Stat., U. S.).—All claims for the refunding of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, must be presented to the Commissioner of Internal Revenue within two years next after the cause of action accrued: *Provided*, That claims which accrued prior to June six, eighteen hundred and seventy-two, may be presented to the commissioner at any time within one year from said date. But nothing in this section shall be construed to revive any right of action which was already barred by any statute on that date.
- 757** Section 14 (a), act of September 8, 1916, provides that upon the examination of any return of income made pursuant to the act of August 5, 1909, levying an excise tax, and the acts of October 3, 1913, September 8, 1916 (and same act as amended Oct. 3, 1917), and the act of October 3, 1917, *levying an income tax*, "and for other purposes," if it shall appear that amounts of tax have been paid in excess of those properly due, the taxpayer shall be permitted to present a claim for refund thereof notwithstanding the provisions of section 3228 of the Revised Statutes.
- 758** Art. 270. The lodging of an appeal (claim for refund) made out in due form with the proper collector of internal revenue, for the purpose of transmission to the Commissioner of Internal Revenue in the usual course of business under the requirements of the regula-

tions of the Secretary of the Treasury, is in legal effect a presentation of the appeal to the commissioner. (14 Otto, 728; 28 Int. Rev. Rec., 87.)

Art. 271. All claims for the refunding of taxes should be received 759 by the collector and forwarded to the Commissioner of Internal Revenue. In no case should the collector refuse to forward a claim for the reason that it was not presented to him within two years after payment of tax.

Art. 272. The collector should keep a perfect record, in the book 760 furnished for the purpose, of all claims presented to the commissioner, and must certify as to each claim whether it has been before presented or not.

Art. 273. If any claim on form 46 or 47 is presented without the 761 affidavit of the deputy collector, the reason for the omission must be given.

If in any case, after a full investigation, the collector can not cer- 762 tify to the facts set forth in the affidavits, he should state the reason for his dissent, and allow the party to corroborate his statements by such other proof as he may be able to furnish.

All amendments in the statement of facts in claims must be made 763 under oath.

All copies should be certified to be true ones. 764

Care should be taken to certify, in every instance where a previous 765 claim has been presented in the same case, the date of the previous claim.

When an affidavit is made upon form 46 by some other party than 766 the one against whom the tax was assessed, the name of the party assessed should appear upon the outside of that form.

When a firm is the claimant the claim should be in the name of the 767 firm; but a member of the firm or authorized agent or attorney should swear to the facts set forth, including that of membership or agency, and should subscribe his individual name. The artificial person, to wit, the firm, can not make oath.

In claims for abatement or refunding the collector will in all cases 768 insert in his certificate the *full amount of the assessment, and not simply the amount claimed.*

When the collector has twice collected the tax upon the same 769 assessment he will charge himself with the duplicate payment on form 58; and when a claim is made he will state in his certificate, upon form 46, that he has so charged himself with said amount, stating the month, list, page, line, amount, and date of payment.

When a claim for refunding is made on the ground of a duplicate 770 assessment and payment, the collector will certify to the duplicate assessment and payment on form 46, giving the full amount both of

the assessment and of the payment, and will also give the page, list, and line in each case.

- 771 Many of the rules for the preparation of claims upon form 47 are equally applicable to the preparation of those upon form 46. They should be followed wherever they are not manifestly inapplicable.

CLAIMS FOR SUMS RECOVERED BY SUIT.

- 772 **Art. 274.** Claims for sums of money recovered by suit for any of the causes, and against any of the officers, enumerated in section 3220, Revised Statutes, should be made upon form 46. The claimant should state the grounds of his claim under oath, giving the names of all the parties to the suit, the cause of action, date of its commencement, the date of the judgment, court in which it was recovered, and its amount. To this affidavit there should be annexed a duly certified copy of the record of the court in the case, copy of the final judgment, certificate of probable cause, and itemized bill of costs paid receipted by the clerk or other proper officer of the court.
- 773 **Art. 275. Section 989, Revised Statutes.**—When a recovery is had in any suit or proceeding against a collector or other officer of the revenue for any act done by him, or for the recovery of any money exacted by or paid to him, and by him paid into the Treasury, in the performance of his official duty, and the court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the Government, no execution shall issue against such collector or other officer; but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury.
- 774 In view of the foregoing provisions protecting the collector from personal liability in case the court certifies that there was probable cause for the act done by him, it will be observed that it is for the interest of the collector to see that in all cases where judgment is rendered against him the court shall be asked to give the certificate of probable cause.
- 775 If the judgment debtor shall have already paid the amount recovered against him, the claim should be made in his name, and the affidavit should state the exact amount paid by him. There should also be a certificate of the clerk of the court in which the judgment was recovered (or other satisfactory evidence), showing that the judgment has been satisfied, and specifying the exact sum paid in its satisfaction, with a detail of all items of cost paid, or for which the judgment debtor is liable.

APPENDIX.

INCOME TAX ACTS.

Income tax act of September 8, 1916, as amended by act of October 3, 1917, and war income tax act of October 3, 1917, effective October 4, 1917, except as otherwise provided.

[Public No. 271, 64th Congress—H. R. 16763.]

AN ACT To increase the revenue, and for other purposes.

TITLE I.—INCOME TAX.

PART I.—ON INDIVIDUALS.

SEC. 1. (a) That there shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources by every individual, a citizen or resident of the United States, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources within the United States by every individual, a nonresident alien, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise.

(b) In addition to the income tax imposed by subdivision (a) of this section (herein referred to as the normal tax) there shall be levied, assessed, collected, and paid upon the total net income of every individual, or, in the case of a nonresident alien, the total net income received from all sources within the United States, an additional income tax (herein referred to as the additional tax) of one per centum per annum upon the amount by which such total net income exceeds \$20,000 and does not exceed \$40,000, two per centum per annum upon the amount by which such total net income exceeds \$40,000 and does not exceed \$60,000, three per centum per annum upon the amount by which such total net income exceeds \$60,000 and does not exceed \$80,000, four per centum per annum upon the amount by which such total net income exceeds \$80,000 and does not exceed \$100,000, five per centum per annum upon the amount by which such total net income exceeds \$100,000 and does not exceed \$150,000, six per centum per annum upon the amount by which such total net

income exceeds \$150,000 and does not exceed \$200,000, seven per centum per annum upon the amount by which such total net income exceeds \$200,000 and does not exceed \$250,000, eight per centum per annum upon the amount by which such total net income exceeds \$250,000 and does not exceed \$300,000, nine per centum per annum upon the amount by which such total net income exceeds \$300,000 and does not exceed \$500,000, ten per centum per annum upon the amount by which such total net income exceeds \$500,000 and does not exceed \$1,000,000, eleven per centum per annum upon the amount by which such total net income exceeds \$1,000,000 and does not exceed \$1,500,000, twelve per centum per annum upon the amount by which such total net income exceeds \$1,500,000 and does not exceed \$2,000,000, and thirteen per centum per annum upon the amount by which such total net income exceeds \$2,000,000.

For the purpose of the additional tax there shall be included as income the income derived from dividends on the capital stock or from the net earnings of any corporation, joint-stock company or association, or insurance company, except that in the case of non-resident aliens such income derived from sources without the United States shall not be included.

All the provisions of this title relating to the normal tax on individuals, so far as they are applicable and are not inconsistent with this subdivision and section three, shall apply to the imposition, levy, assessment, and collection of the additional tax imposed under this subdivision.

(c) The foregoing normal and additional tax rates shall apply to the entire net income, except as hereinafter provided, received by every taxable person in the calendar year nineteen hundred and sixteen and in each calendar year thereafter.

INCOME DEFINED.

SEC. 2. (a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

(b) Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates, and also

such income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed, the tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed to the executor, administrator, or trustee, as the case may be: *Provided*, That where the income is to be distributed annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.

Such trustees, executors, administrators, and other fiduciaries are hereby indemnified against the claims or demands of every beneficiary for all payments of taxes which they shall be required to make under the provisions of this title, and they shall have credit for the amount of such payments against the beneficiary or principle in any accounting which they make as such trustees or other fiduciaries.

(c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived.

ADDITIONAL TAX INCLUDES UNDISTRIBUTED PROFITS.

SEC. 3. For the purpose of the additional tax, the taxable income of any individual shall include the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint-stock companies or associations, or insurance companies, however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed; and the fact that any such corporation, joint-stock company or association, or insurance company, is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a fraudulent purpose to escape such tax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint-stock company or association, or insur-

ance company shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed.

INCOME EXEMPT FROM LAW.

SEC. 4. The following income shall be exempt from the provisions of this title:

The proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured; the amount received by the insured, as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract; the value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included as income); interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States (but, in the case of obligations of the United States issued after September first, nineteen hundred and seventeen, only if and to the extent provided in the Act authorizing the issue thereof)¹ or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July seventeenth, nineteen hundred and sixteen; the compensation of the present President of the United States during the term for which he has been elected and the judges of the supreme and inferior courts of the United States now in office, and the compensation of all officers and employees of a State, or any political subdivision thereof, except when such compensation is paid by the United States Government.

DEDUCTIONS ALLOWED.

SEC. 5. That in computing net income in the case of a citizen or resident of the United States—

(a) For the purpose of the tax there shall be allowed as deductions—

First. The necessary expenses actually paid in carrying on any business or trade, not including personal, living, or family expenses;

¹ Public No. 43, 65th Congress (H. R. 5901) An Act to authorize an additional issue of bonds to meet expenditures for the national security and defense, and for other purposes.—Approved Sept. 24, 1917.

SEC. 7. That none of the bonds authorized by section one, nor of the certificates authorized by section five, or by section six, of this Act, shall bear the circulation privilege. All such bonds and certificates shall be exempt, both as to principal and interest from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) *estate or inheritance taxes*, and (b) *graduated additional income taxes*, commonly known as surtaxes, and *excess profits and war-profits taxes*, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of such bonds and certificates the *principal of which does not exceed in the aggregate \$5,000*, owned by any individual, partnership, association, or corporation, shall be exempt from the taxes provided for in subdivision (b) of this section.

Second. All interest paid within the year on his indebtedness except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title;

Third. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes) or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits;

Fourth. Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided*, That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;

Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom;

Sixth. Debts due to the taxpayer actually ascertained to be worthless and charged off within the year;

Seventh. A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

Eighth. (a) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowances authorized (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made. No deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of re-

storing property or making good the exhaustion thereof for which an allowance is or has been made.

Ninth. Contributions or gifts actually made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

CREDITS ALLOWED.

(b) For the purpose of the normal tax only, the income embraced in a personal return shall be credited with the amount received as dividends upon the stock or from the net earnings of any corporation, joint-stock company or association, trustee, or insurance company, which is taxable upon its net income as hereinafter provided;

(c) A like credit shall be allowed as to the amount of income, the normal tax upon which has been paid or withheld for payment at the source of the income under the provisions of this title.

NONRESIDENT ALIENS.

SEC. 6. That in computing net income in the case of a nonresident alien—

(a) For the purpose of the tax there shall be allowed as deductions—

First. The necessary expenses actually paid in carrying on any business or trade conducted by him within the United States, not including personal, living, or family expenses;

Second. The proportion of all interest paid within the year by such person on his indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) which the gross amount of his income for the year derived from sources within the United States bears to the gross amount of his income for the year derived from all sources within and without the United States, but this deduction shall be allowed only if such person includes in the return required by section eight all the information necessary for its calculation;

Third. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes) or of its Territories, or possessions, or by the authority of any State, county,

school district, or municipality; or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits;

Fourth. Losses actually sustained during the year, incurred in business or trade conducted by him within the United States, and losses of property within the United States arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided*, That for the purpose of ascertaining the amount of such loss or losses sustained in trade, or speculative transactions not in trade, from the same or any kind of property acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss or losses sustained;

Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom in the United States;

Sixth. Debts arising in the course of business or trade conducted by him within the United States due to the taxpayer actually ascertained to be worthless and charged off within the year;

Seventh. A reasonable allowance for the exhaustion, wear and tear of property within the United States arising out of its use or employment in the business or trade; (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made. No deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made.

(b) There shall also be allowed the credits specified by subdivisions (b) and (c) of section five.

(c) A nonresident alien individual shall receive the benefit of the deductions and credits provided for in this section only by filing or

causing to be filed with the collector of internal revenue a true and accurate return of his total income, received from all sources, corporate or otherwise, in the United States, in the manner prescribed by this title; and in case of his failure to file such return the collector shall collect the tax on such income, and all property belonging to such nonresident alien individual shall be liable to distraint for the tax.

PERSONAL EXEMPTION.

SEC. 7. That for the purpose of the normal tax only, there shall be allowed as an exemption in the nature of a deduction from the amount of the net income of each citizen or resident of the United States, ascertained as provided herein, the sum of \$3,000, plus \$1,000 additional if the person making the return be a head of a family or a married man with a wife living with him, or plus the sum of \$1,000 additional if the person making the return be a married woman with a husband living with her; but in no event shall this additional exemption of \$1,000 be deducted by both a husband and a wife: *Provided*, That only one deduction of \$4,000 shall be made from the aggregate income of both husband and wife when living together: *Provided further*, That if the person making the return is the head of a family there shall be an additional exemption of \$200 for each child dependent upon such person, if under eighteen years of age, or if incapable of self-support because mentally or physically defective, but this provision shall operate only in the case of one parent in the same family: *Provided further*, That guardians or trustees shall be allowed to make this personal exemption as to income derived from the property of which such guardian or trustee has charge in favor of each ward or cestui que trust: *Provided further*, That in no event shall a ward or cestui que trust be allowed a greater personal exemption than as provided in this section, from the amount of net income received from all sources. There shall also be allowed an exemption from the amount of the net income of estates of deceased citizens or residents of the United States during the period of administration or settlement, and of trust or other estates of citizens or residents of the United States the income of which is not distributed annually or regularly under the provisions of subdivision (b) of section two, the sum of \$3,000, including such deductions as are allowed under section five.

(b) [Repealed.]

RETURNS.

SEC. 8. (a) The tax shall be computed upon the net income, as thus ascertained, of each person subject thereto, received in each preceding calendar year ending December thirty-first.

(b) On or before the first day of March, nineteen hundred and seventeen, and the first day of March in each year thereafter, a true and accurate return under oath shall be made by each person of lawful age, except as hereinafter provided, having a net income of \$5,000 or over for the taxable year to the collector of internal revenue for the district in which such person has his legal residence or principal place of business, or if there be no legal residence or place of business in the United States, then with the collector of internal revenue at Baltimore, Maryland, in such form as the Commissioner

Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income from all separate sources, and from the total thereof deducting the aggregate items of allowances herein authorized: *Provided*, That the Commissioner of Internal Revenue shall have authority to grant a reasonable extension of time, in meritorious cases, for filing returns of income by persons residing or traveling abroad who are required to make and file returns of income and who are unable to file said returns on or before March first of each year: *Provided further*, That the aforesaid return may be made by an agent when by reason of illness, absence, or nonresidence the person liable for said return is unable to make and render the same, the agent assuming the responsibility of making the return and incurring penalties provided for erroneous, false, or fraudulent return.

(c) Guardians, trustees, executors, administrators, receivers, conservators, and all persons, corporations, or associations, acting in any fiduciary capacity, shall make and render a return of the income of the person, trust, or estate for whom or which they act, and be subject to all the provisions of this title which apply to individuals. Each fiduciary shall make oath that he has sufficient knowledge of the affairs of such person, trust, or estate to enable him to make such return and that the same is, to the best of his knowledge and belief, true and correct, and be subject to all the provisions of this title which apply to individuals: *Provided*, That a return made by one of two or more joint fiduciaries filed in the district where such fiduciary resides, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph: *Provided further*, That no return of income not exceeding \$3,000 shall be required except as in this title otherwise provided.

(d) [Repealed.]

(e) Persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid under the provisions of

this title: *Provided*, That from the net distributive interests on which the individual members shall be liable for tax, normal and additional, there shall be excluded their proportionate shares received from interests on the obligations of a State or any political or taxing subdivision thereof, and upon the obligations of the United States (if and to the extent that it is provided in the Act authorizing the issue of such obligations of the United States that they are exempt from taxation), and its possessions, and that for the purpose of computing the normal tax there shall be allowed a credit, as provided by section five, subdivision (b), for their proportionate share of the profits derived from dividends. Such partnership, when requested by the Commissioner of Internal Revenue or any district collector, shall render a correct return of the earnings, profits, and income of the partnership, except income exempt under section four of this Act, setting forth the item of the gross income and the deductions and credits allowed by this title, and the names and addresses of the individuals who would be entitled to the net earnings, profits, and income, if distributed. A partnership shall have the same privilege of fixing and making returns upon the basis of its own fiscal year as is accorded to corporations under this title. If a fiscal year ends during nineteen hundred and sixteen or a subsequent calendar year for which there is a rate of tax different from the rate for the preceding calendar year, then (1) the rate for such preceding calendar year shall apply to an amount of each partner's share of such partnership profits equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rate for the calendar year during which such final year ends shall apply to the remainder.

(f) In every return shall be included the income derived from dividends on the capital stock or from the net earnings of any corporation, joint-stock company or association, or insurance company, except that in the case of nonresident aliens such income derived from sources without the United States shall not be included.

(g) An individual keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect his income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make his return upon the basis upon which his accounts are kept, in which case the tax shall be computed upon his income as so returned.

ASSESSMENT AND ADMINISTRATION.

SEC. 9. (a) That all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said amount shall be paid

a or before the fifteenth day of June, except in cases of refusal or neglect to make such return and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, or has been made, make a return upon information obtained as provided for in this title or by existing law, or require the necessary corrections to be made, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by each person or persons immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the fifteenth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid, and interest at the rate of one per centum per month upon said tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons.

(b) All persons, corporations, partnerships, associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensations, remuneration, moluments, or other fixed or determinable annual or periodical gains, profits, and income of any nonresident alien individual, other than income derived from dividends on capital stock, or from the net earnings of a corporation, joint-stock company or association, or insurance company, which is taxable upon its net income as provided in this title, are hereby authorized and required to deduct and withhold from such annual or periodical gains, profits, and income such sum as will be sufficient to pay the normal tax imposed thereon by this title, and shall make return thereof on or before March first of each year and, on or before the time fixed by law for the payment of the tax, shall pay the amount withheld to the officer of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax, and they are each hereby indemnified against every person, corporation, partnership, association, or insurance company, or demand whatsoever for all payments which they shall make in pursuance and by virtue of this title.

(c) The amount of the normal tax hereinbefore imposed shall also be deducted and withheld from fixed or determinable annual or periodical gains, profits and income derived from interest upon bonds and mortgages, or deeds of trust or other similar obligations of corporations, joint-stock companies, associations, and insurance companies (if such bonds, mortgages, or other obligations contain a contract or provision by which the obligor agrees to pay any portion of

the tax imposed by this title upon the obligee or to reimburse the obligee for any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the United States), whether payable annually or at shorter or longer periods and whether such interest is payable to a nonresident alien individual or to an individual citizen or resident of the United States, subject to the provisions of the foregoing subdivision (b) of this section requiring the tax to be withheld at the source and deducted from annual income and returned and paid to the Government, unless the person entitled to receive such interest shall file with the withholding agent, on or before February first, a signed notice in writing claiming the benefit of an exemption under section seven of this title.

(d) [Repealed.]

(e) [Repealed.]

(f) All persons, corporations, partnerships, or associations, undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner of Internal Revenue, and shall be subject to such regulations enabling the Government to obtain the information required under this title, as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and whoever knowingly undertakes to collect such payments as aforesaid without having obtained a license therefor, or without complying with such regulations, shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding \$5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court.

(g) The tax herein imposed upon gains, profits, and incomes not falling under the foregoing and not returned and paid by virtue of the foregoing or as otherwise provided by law shall be assessed by personal return under rules and regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury. The intent and purpose of this title is that all gains, profits, and income of a taxable class, as defined by this title, shall be charged and assessed with the corresponding tax, normal and additional, prescribed by this title, and said tax shall be paid by the owner of such income, or the proper representative having the receipt, custody, control, or disposal of the same. For the purpose of this title ownership or liability shall be determined as of the year for which a return is required to be rendered.

The provisions of this section, except subdivision (c), relating to the deduction and payment of the tax at the source of income shall only apply to the normal tax hereinbefore imposed upon nonresident alien individuals.

PART II.—ON CORPORATIONS.

SEC. 10. (a) That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized, but not including partnerships, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources within the United States by every corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including the income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies or associations, or insurance companies, whose net income is taxable under this title.

The foregoing tax rate shall apply to the total net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and sixteen and in each year thereafter, except that if it has fixed its own fiscal year under the provisions of existing law, the foregoing rate shall apply to the proportion of the total net income returned for the fiscal year ending prior to December thirty-first, nineteen hundred and sixteen, which the period between January first, nineteen hundred and sixteen, and the end of such fiscal year bears to the whole of such fiscal year, and the rate fixed in Section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," shall apply to the remaining portion of the total net income returned for such fiscal year.

For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company or association, or insurance company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained.

(b) In addition to the income tax imposed by subdivision (a) of this section there shall be levied, assessed, collected, and paid annually an additional tax of ten per centum upon the amount, remaining undistributed six months after the end of each calendar or fiscal year, of the total net income of every corporation, joint-stock company or association, or insurance company, received during the year, as deter-

mined for the purposes of the tax imposed by such subdivision (a), but not including the amount of any income taxes paid by it within the year imposed by the authority of the United States.

The tax imposed by this subdivision shall not apply to that portion of such undistributed net income which is actually invested and employed in the business or is retained for employment in the reasonable requirements of the business or is invested in obligations of the United States issued after September first, nineteen hundred and seventeen: *Provided*, That if the Secretary of the Treasury ascertains and finds that any portion of such amount so retained at any time for employment in the business is not so employed or is not reasonably required in the business a tax of fifteen per centum shall be levied, assessed, collected, and paid thereon.

The foregoing tax rates shall apply to the undistributed net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and seventeen and in each year thereafter, except that if it has fixed its own fiscal year under the provisions of existing law, the foregoing rates shall apply to the proportion of the taxable undistributed net income returned for the fiscal year ending prior to December thirty-first, nineteen hundred and seventeen, which the period between January first, nineteen hundred and seventeen, and the end of such fiscal year bears to the whole of such fiscal year.

CONDITIONAL AND OTHER EXEMPTIONS.

SEC. 11. (a) That there shall not be taxed under this title any income received by any—

First. Labor, agricultural, or horticultural organization;

Second. Mutual savings bank not having a capital stock represented by shares;

Third. Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

Fourth. Domestic building and loan association and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

Fifth. Cemetery company owned and operated exclusively for the benefit of its members;

Sixth. Corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual;

Seventh. Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;

Eighth. Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;

Ninth. Club organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member;

Tenth. Farmers' or other mutual hail, cyclone, or fire insurance company, mutual ditch or irrigation company, mutual or cooperative telephone company, or like organization of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting its expenses;

Eleventh. Farmers', fruit growers', or like association, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

Twelfth. Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; or

Thirteenth. Federal land banks and national farm-loan associations as provided in section twenty-six of the Act approved July seventeenth, nineteen hundred and sixteen, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

Fourteenth. Joint stock land banks as to income derived from bonds or debentures of other joint stock land banks or any Federal land bank belonging to such joint stock land bank.

(b) There shall not be taxed under this title any income derived from any public utility or from the exercise of any essential governmental function accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, nor any income accruing to the government of the Philippine Islands or Porto Rico, or of any political subdivision of the Philippine Islands or Porto Rico: *Provided*, That whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, has, prior to the passage of this title, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate, or maintain a public utility, no tax shall be levied under the provisions of this title upon

the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political subdivision of a State or Territory; but this provision is not intended to confer upon such person or corporation any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this title upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

DEDUCTIONS.

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; and (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*, That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion

thereof for which an allowance is or has been made: *Provided further*, That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof, and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;

Third. The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding: *Provided*, That for the purpose of this title preferred capital stock shall not be considered interest-bearing indebtedness, and interest or dividends paid upon this stock shall not be deductible from gross income: *Provided further*, That in cases wherein shares of capital stock are issued without par or nominal value, the amount of paid-up capital stock, within the meaning of this section, as represented by such shares, will be the amount of cash, or its equivalent, paid or transferred to the corporation as a consideration for such shares: *Provided further*, That in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint-stock company or association as a dealer only in the property constituting such collateral, or in loaning the funds thereby procured, the total interest paid by such corporation, company, or association within the year on any such indebtedness may be deducted as a part of its expenses of doing business, but interest on such indebtedness

shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral: *Provided further*, That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed, or any other tax paid pursuant to such guaranty, shall be allowed; and in the case of a bank, banking association, loan or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company shall be deducted;

Fourth. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits.

(b) In the case of a corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources within the United States—

First. All the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

Second. All losses actually sustained within the year in business or trade conducted by it within the United States and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; (a) and in the case (a) of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b), under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; and

(c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*, That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made: *Provided further*, That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof, and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;

Third. The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the proportion of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of the capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding, which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States: *Provided*, That in the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed or any other tax paid pursuant to such guaranty shall be allowed; and in case of a bank, banking association, loan or trust company, or branch

thereof, interest paid within the year on deposits by or on moneys received for investment from either citizens or residents of the United States and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company, or branch thereof;

Fourth. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits.

(c) In the case of assessment insurance companies, whether domestic or foreign, the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guarantee or reserve funds shall be treated as being payments required by law to reserve funds.

RETURNS.

SEC. 13. (a) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first: *Provided*, That any corporation, joint-stock company or association, or insurance company, subject to this tax, may designate the last day of any month in the year as the day of the closing of its fiscal year and shall be entitled to have the tax payable by it computed upon the basis of the net income ascertained as herein provided for the year ending on the day so designated in the year preceding the date of assessment instead of upon the basis of the net income for the calendar year preceding the date of assessment; and it shall give notice of the day it has thus designated as the closing of its fiscal year to the collector of the district in which its principal business office is located at any time not less than thirty days prior to the first day of March of the year in which its return would be filed if made upon the basis of the calendar year;

(b) Every corporation, joint-stock company or association, or insurance company, subject to the tax herein imposed, shall, on or before the first day of March, nineteen hundred and seventeen, and the first day of March in each year thereafter, or, if it has designated a fiscal year for the computation of its tax, then within sixty days after the close of such fiscal year ending prior to December thirty-first, nineteen hundred and sixteen, and the close of each such fiscal year thereafter, render a true and accurate return of its annual net income in the manner and form to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and containing such facts, data, and information as are appropriate and in the opinion of the commissioner necessary to determine the correctness of the net income returned and to carry out

the provisions of this title. The return shall be sworn to by the president, vice president, or other principal officer, and by the treasurer or assistant treasurer. The return shall be made to the collector of the district in which is located the principal office of the corporation, company, or association, where are kept its books of account and other data from which the return is prepared, or in the case of a foreign corporation, company, or association, to the collector of the district in which is located its principal place of business in the United States, or if it have no principal place of business, office, or agency in the United States, then to the collector of internal revenue at Baltimore, Maryland. All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue;

(c) In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control;

(d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;

(e) All the provisions of this title relating to the tax authorized and required to be deducted and withheld and paid to the officer of the United States Government authorized to receive the same from the income of nonresident alien individuals from sources within the United States shall be made applicable to the tax imposed by subdivision (a) of section ten upon incomes derived from interest upon bonds and mortgages or deeds of trust or similar obligations of domestic or other resident corporations, joint-stock companies or associations, and insurance companies by nonresident alien firms, copartnerships, companies, corporations, joint-stock companies or associations, and insurance companies, not engaged in business or trade within the United States and not having any office or place of business therein.

(f) Likewise, all the provisions of this title relating to the tax authorized and required to be deducted and withheld and paid to the officer of the United States Government authorized to receive the same from the income of nonresident alien individuals from sources within the United States shall be made applicable to income derived from dividends upon the capital stock or from the net earnings of domestic or other resident corporations, joint-stock companies or associations, and insurance companies by nonresident alien companies, corporations, joint-stock companies or associations, and insurance companies not engaged in business or trade within the United States and not having any office or place of business therein.

ASSESSMENT AND ADMINISTRATION.

SEC. 14. (a) All assessments shall be made and the several corporations, joint-stock companies or associations, and insurance companies shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessment shall be paid on or before the fifteenth day of June: *Provided*, That every corporation, joint-stock company or association, and insurance company, computing taxes upon the income of the fiscal year which it may designate in the manner hereinbefore provided, shall pay the taxes due under its assessment within one hundred and five days after the date upon which it is required to file its list or return of income for assessment; except in cases of refusal or neglect to make such return, and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this title or by existing law; and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint-stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the fifteenth day of June in any year, or after one hundred and five days from the date on which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due: *Provided*, That upon the examination of any return of income made pursuant to this title, the Act of August fifth, nineteen hundred and nine, entitled, "An Act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes,"

and the Act of October third, nineteen hundred and thirteen, entitled, "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," if it shall appear that amounts of tax have been paid in excess of those properly due, the taxpayer shall be permitted to present a claim for refund thereof notwithstanding the provisions of section thirty-two hundred and twenty-eight of the Revised Statutes;

(b) When the assessment shall be made, as provided in this title, the returns together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such: *Provided*, That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President: *Provided further*, That the proper officers of any State imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint-stock company or association, or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe;

(c) If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid shall refuse or neglect to make return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to penalty of not exceeding \$10,000: *Provided*, That the Commissioner of Internal Revenue shall have authority, in the case of either corporations or individuals, to grant a reasonable extension of time in meritorious cases, as he may deem proper.

(d) That section thirty-two hundred and twenty-five of the Revised Statutes of the United States be, and the same is hereby, amended so as to read as follows:

"SEC. 3225. When a second assessment is made in case of any list, statement, or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, no tax collected under such assessment shall be recovered by any suit unless it is proved that the said list, statement, or return was not false nor fraudulent and did not contain any understatement or undervaluation, but this section shall not apply to statements or returns made or to be made in good faith under the laws of the United States regarding annual depreciation of oil or gas wells and mines."

PART III.—GENERAL ADMINISTRATIVE PROVISIONS.

SEC. 15. That the word "State" or "United States" when used in this title shall be construed to include any Territory, the District of Columbia, Porto Rico, and the Philippine Islands, when such construction is necessary to carry out its provisions.

SEC. 16. That sections thirty-one hundred and sixty-seven, thirty-one hundred and seventy-two, thirty-one hundred and seventy-three and thirty-one hundred and seventy-six of the Revised Statutes of the United States as amended are hereby amended so as to read as follows:

"SEC. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding \$1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment.

"SEC. 3172. Every collector shall, from time to time, cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal-revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects.

"SEC. 3173. It shall be the duty of any person, partnership, firm, association, or corporation, made liable to any duty, special tax, or other tax imposed by law, when not otherwise provided for, (1) in case of a special tax, on or before the thirty-first day of July in each year, (2) in case of income tax on or before the first day of March in each year, or on or before the last day of the sixty-day period next following the closing date of the fiscal year for which it makes a return of its income, and (3) in other cases before the day on which the taxes accrue, to make a list or return, verified by oath, to the col-

lector or a deputy collector of the district where located, of the articles or objects, including the amount of annual income charged with a duty or tax, the quantity of goods, wares, and merchandise, made or sold and charged with a tax, the several rates and aggregate amount, according to the forms and regulations to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, for which such person, partnership, firm, association, or corporation is liable: *Provided*, That if any person liable to pay any duty or tax, or owning, possessing, or having the care or management of property, goods, wares, and merchandise, article or objects liable to pay any duty, tax, or license, shall fail to make and exhibit a list or return required by law, but shall consent to disclose the particulars of any and all the property, goods, wares, and merchandise, articles, and objects liable to pay any duty or tax, or any business or occupation liable to pay any tax as aforesaid, then, and in that case, it shall be the duty of the collector or deputy collector to make such list or return, which, being distinctly read, consented to, and signed and verified by oath by the person so owning, possessing, or having the care and management as aforesaid, may be received as the list of such persons: *Provided further*, That in case no annual list or return has been rendered by such person to the collector or deputy collector as required by law, and the person shall be absent from his or her residence or place of business at the time the collector or a deputy collector shall call for the annual list or return, it shall be the duty of such collector or deputy collector to leave at such place of residence or business, with some one of suitable age and discretion, if such be present, otherwise to deposit in the nearest post office, a note or memorandum addressed to such person, requiring him or her to render to such collector or deputy collector the list or return required by law within ten days from the date of such note or memorandum, verified by oath. And if any person, on being notified or required as aforesaid, shall refuse or neglect to render such list or return within the time required as aforesaid, or whenever any person who is required to deliver a monthly or other return of objects subject to tax fails to do so at the time required, or delivers any return which, in the opinion of the collector, is erroneous, false, or fraudulent, or contains any undervaluation or understatement, or refuses to allow any regularly authorized Government officer to examine the books of such person, firm, or corporation, it shall be lawful for the collector to summon such person, or any other person having possession, custody, or care of books of account containing entries relating to the business of such person or any other person he may deem proper, to appear before him and produce such books at a time and place named in the summons, and to give testimony or answer interrogatories, under oath,

respecting any objects or income liable to tax or the returns thereof. The collector may summon any person residing or found within the State or Territory in which his district lies; and when the person intended to be summoned does not reside and can not be found within such State or Territory, he may enter any collection district where such person may be found and there make the examination herein authorized. And to this end he may there exercise all the authority which he might lawfully exercise in the district for which he was commissioned: *Provided*, That 'person,' as used in this section, shall be construed to include any corporation, joint-stock company or association, or insurance company when such construction is necessary to carry out its provisions.

"SEC. 3176. If any person, corporation, company, or association fails to make and file a return or list at the time prescribed by law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. Any return or list so made and subscribed by a collector or deputy collector shall be prima facie good and sufficient for all legal purposes.

"If the failure to file a return or list is due to sickness or absence the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper.

"The Commissioner of Internal Revenue shall assess all taxes, other than stamp taxes, as to which returns or lists are so made by a collector or deputy collector. In case of any failure to make and file a return or list within the time prescribed by law or by the collector, the Commissioner of Internal Revenue shall add to the tax fifty per centum of its amount except that, when a return is voluntarily and without notice from the collector filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax one hundred per centum of its amount.

"The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax."

SEC. 17. That it shall be the duty of every collector of internal revenue, to whom any payment of any taxes is made under the provisions of this title, to give to the person making such payment a full written or printed receipt, expressing the amount paid and the particular account for which such payment was made; and whenever

such payment is made such collector shall, if required, give a separate receipt for each tax paid by any debtor, on account of payments made to or to be made by him to separate creditors in such form that such debtor can conveniently produce the same separately to his several creditors in satisfaction of their respective demands to the amounts specified in such receipts; and such receipts shall be sufficient evidence in favor of such debtor to justify him in withholding the amount therein expressed from his next payment to his creditor; but such creditor may, upon giving to his debtor a full written receipt, acknowledging the payment to him of whatever sum may be actually paid, and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

SEC. 18. That any person, corporation, partnership, association, or insurance company, liable to pay the tax, to make a return or to supply information required under this title, who refuses or neglects to pay such tax, to make such return or to supply such information at the time or times herein specified in each year, shall be liable, except as otherwise specially provided in this title, to a penalty of not less than \$20 nor more than \$1,000. Any individual or any officer of any corporation, partnership, association, or insurance company, required by law to make, render, sign, or verify any return or to supply any information, who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this title to be made, shall be guilty of a misdemeanor, and shall be fined not exceeding \$2,000 or be imprisoned not exceeding one year, or both, in the discretion of the court, with the costs of prosecution: *Provided*, That where any tax heretofore due and payable has been duly paid by the taxpayer, it shall not be re-collected from any withholding agent required to retain it at its source, nor shall any penalty be imposed or collected in such cases from the taxpayer, or such withholding agent whose duty it was to retain it, for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

SEC. 19. That the collector or deputy collector shall require every return to be verified by the oath of the party rendering it. If the collector or deputy collector have reason to believe that the amount of any income returned is understated, he shall give due notice to the person making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated may increase the same accordingly. Such person may furnish sworn testimony to prove any relevant facts, and, if dissatisfied with the decision of the collector, may appeal to the Commissioner of Internal Revenue for his decision under such rules of procedure as may be prescribed by regulation.

SEC. 20. That jurisdiction is hereby conferred upon the district courts of the United States for the district within which any person summoned under this title to appear to testify or to produce books shall reside, to compel such attendance, production of books, and testimony by appropriate process.

SEC. 21. That the preparation and publication of statistics reasonably available with respect to the operation of the income tax law and containing classifications of taxpayers and of income, the amounts allowed as deductions and exemptions, and any other facts deemed pertinent and valuable, shall be made annually by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury.

SEC. 22. That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this title, are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed.

SEC. 23. That the provisions of this title shall extend to Porto Rico and the Philippine Islands: *Provided*, That the administration of the law and the collection of the taxes imposed in Porto Rico and the Philippine Islands shall be by the appropriate internal-revenue officers of those governments, and all revenues collected in Porto Rico and the Philippine Islands thereunder shall accrue intact to the general governments thereof, respectively: *Provided further*, That the jurisdiction in this title conferred upon the district courts of the United States shall, so far as the Philippine Islands are concerned, be vested in the courts of the first instance of said islands: *And provided further*, That nothing in this title shall be held to exclude from the computation of the net income the compensation paid any official by the governments of the District of Columbia, Porto Rico, and the Philippine Islands, or the political subdivisions thereof.

SEC. 24. That section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," is hereby repealed, except as herein otherwise provided, and except that it shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any of such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the administration of such section or any provision thereof shall be available for the administration of this title or the corresponding provision thereof.

SEC. 25. That income on which has been assessed the tax imposed by section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October third, nineteen hundred and thirteen, shall not be considered as income within the meaning of this title: *Provided*, That this section shall not conflict with that portion of section ten, of this title, under which a taxpayer has fixed its own fiscal year.

SEC. 26. Every corporation, joint-stock company or association, or insurance company subject to the tax herein imposed, when required by the Commissioner of Internal Revenue, shall render a correct return, duly verified under oath, of its payments of dividends, whether made in cash or its equivalent or in stock, including the names and addresses of stockholders and the number of shares owned by each, and the tax years and the applicable amounts in which such dividends were earned, in such form and manner as may be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

SEC. 27. That every person, corporation, partnership, or association, doing business as a broker on any exchange or board of trade or other similar place of business shall, when required by the Commissioner of Internal Revenue, render a correct return duly verified under oath, under such rules and regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, showing the name of customers for whom such person, corporation, partnership, or association has transacted any business, with such details as to the profits, losses, or other information which the commissioner may require, as to each of such customers, as will enable the Commissioner of Internal Revenue to determine whether all income tax due on profits or gains of such customers has been paid.

SEC. 28. That all persons, corporations, partnerships, associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, and employers, making payment to another person, corporation, partnership, association, or insurance company, of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in sections twenty-six and twenty-seven), of \$800 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, are hereby authorized and required to render a true and

accurate return to the Commissioner of Internal Revenue, under such rules and regulations and in such form and manner as may be prescribed by him, with the approval of the Secretary of the Treasury, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment: *Provided*, That such returns shall be required, regardless of amounts, in the case of payments of interest upon bonds and mortgages or deeds of trust or other similar obligations of corporations, joint-stock companies, associations, and insurance companies, and in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest from the bonds and dividends from the stock of foreign corporations by persons, corporations, partnerships, or associations, undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the person, corporation, partnership, association, or insurance company paying the income.

The provisions of this section shall apply to the calendar year nineteen hundred and seventeen and each calendar year thereafter, but shall not apply to the payment of interest on obligations of the United States.

SEC. 29. That in assessing income tax the net income embraced in the return shall also be credited with the amount of any excess profits tax imposed by Act of Congress and assessed for the same calendar or fiscal year upon the taxpayer, and, in the case of a member of a partnership, with his proportionate share of such excess profits tax imposed upon the partnership.

SEC. 30. That nothing in section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," or in this title, shall be construed as taxing the income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest on deposits in banks in the United States of moneys belonging to foreign governments.

SEC. 31. (a) That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

(b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

SEC. 32. That premiums paid on life insurance policies covering the lives of officers, employees, or those financially interested in any trade or business conducted by an individual, partnership, corporation, joint-stock company or association, or insurance company, shall not be deducted in computing the net income of such individual, corporation, joint-stock company or association, or insurance company, or in computing the profits of such partnership for the purposes of subdivision (e) of section nine.

* * * * *

TITLE IX.—ACT SEPTEMBER 8, 1916.

SEC. 900. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of said Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

Effective September 9, 1916.

Effective date of Act as amended, October 4, 1917.

Act October 3, 1917:

SEC. 1302. That unless otherwise herein specially provided, this Act shall take effect on the day following its passage.

Approved, October 3, 1917.

[Public, No. 50, 65th Congress—H. R. 4280.]

AN ACT To provide revenue to defray war expenses, and for other purposes.

TITLE I.—WAR INCOME TAX.

SECTION 1. That in addition to the normal tax imposed by subdivision (a) of section one of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, there shall be levied, assessed, collected, and paid a like normal tax of two per centum upon the income of every individual, a citizen or resident of the United States, received in the calendar year nineteen hundred and seventeen and every calendar year thereafter.

SEC. 2. That in addition to the additional tax imposed by subdivision (b) of section one of such Act of September eighth, nineteen hundred and sixteen, there shall be levied, assessed, collected, and paid a like additional tax upon the income of every individual received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, as follows:

One per centum per annum upon the amount by which the total net income exceeds \$5,000 and does not exceed \$7,500;

Two per centum per annum upon the amount by which the total net income exceeds \$7,500 and does not exceed \$10,000;

Three per centum per annum upon the amount by which the total net income exceeds \$10,000 and does not exceed \$12,500;

Four per centum per annum upon the amount by which the total net income exceeds \$12,500 and does not exceed \$15,000;

Five per centum per annum upon the amount by which the total net income exceeds \$15,000 and does not exceed \$20,000;

Seven per centum per annum upon the amount by which the total net income exceeds \$20,000 and does not exceed \$40,000;

Ten per centum per annum upon the amount by which the total net income exceeds \$40,000 and does not exceed \$60,000;

Fourteen per centum per annum upon the amount by which the total net income exceeds \$60,000 and does not exceed \$80,000;

Eighteen per centum per annum upon the amount by which the total net income exceeds \$80,000 and does not exceed \$100,000;

Twenty-two per centum per annum upon the amount by which the total net income exceeds \$100,000 and does not exceed \$150,000;

Twenty-five per centum per annum upon the amount by which the total net income exceeds \$150,000 and does not exceed \$200,000;

Thirty per centum per annum upon the amount by which the total net income exceeds \$200,000 and does not exceed \$250,000;

Thirty-four per centum per annum upon the amount by which the total net income exceeds \$250,000 and does not exceed \$300,000;

Thirty-seven per centum per annum upon the amount by which the total net income exceeds \$300,000 and does not exceed \$500,000;

Forty per centum per annum upon the amount by which the total net income exceeds \$500,000 and does not exceed \$750,000;

Forty-five per centum per annum upon the amount by which the total net income exceeds \$750,000 and does not exceed \$1,000,000;

Fifty per centum per annum upon the amount by which the total net income exceeds \$1,000,000.

SEC. 3. That the taxes imposed by sections one and two of this Act shall be computed, levied, assessed, collected, and paid upon the same basis and in the same manner as the similar taxes imposed by section one of such Act of September eighth, nineteen hundred and sixteen, except that in the case of the tax imposed by section one of this Act (a) the exemptions of \$3,000 and \$4,000 provided in section seven of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, shall be, respectively, \$1,000 and \$2,000, and (b) the returns required under subdivisions (b) and (c) of section eight of such Act as amended by this Act shall be required in the case of net incomes of \$1,000 or over, in the case of unmarried persons, and \$2,000 or over in the case of married persons, instead of \$3,000 or over, as therein provided, and (c) the provisions of subdivision (c) of section nine of such Act, as amended by this Act, requiring the normal tax of individuals on income derived from interest to be deducted and withheld at the source of the income shall not apply to the new two per centum normal tax prescribed in section one of this Act until on and after January first, nineteen hundred and eighteen, and thereafter only one two per centum normal tax shall be deducted and withheld at the source under the provisions of such subdivision (c), and any further normal tax for which the recipient of such income is liable under this Act or such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, shall be paid by such recipient.

SEC. 4. That in addition to the tax imposed by subdivision (a) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, there shall be levied, assessed, collected, and paid a like tax of four per centum upon the income received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, by every corporation, joint-stock company or association, or insurance company, subject to the tax imposed by that subdivision of that section, except that if it has fixed its own fiscal year, the tax imposed by this section for the fiscal year ending during the calendar year nineteen hundred and seventeen shall be levied, assessed, collected, and paid only on that proportion of its income for such fiscal year which the period between January first,

nineteen hundred and seventeen, and the end of such fiscal year bears to the whole of such fiscal year.

The tax imposed by this section shall be computed, levied, assessed, collected, and paid upon the same incomes and in the same manner as the tax imposed by subdivision (a) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, except that for the purpose of the tax imposed by this section the income embraced in a return of a corporation, joint-stock company or association, or insurance company, shall be credited with the amount received as dividends upon the stock or from the net earnings of any other corporation, joint-stock company or association, or insurance company, which is taxable upon its net income as provided in this title.

SEC. 5. That the provisions of this title shall not extend to Porto Rico or the Philippine Island, and the Porto Rican or Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands, respectively.

TITLE X.—ADMINISTRATIVE PROVISIONS.

* * * * *

SEC. 1001. That all administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act, and every person, corporation, partnership, or association liable to any tax imposed by this Act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may from time to time prescribe.

* * * * *

SEC. 1003. That in all cases where the method of collecting the tax imposed by this Act is not specifically provided, the tax shall be collected in such manner as the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury may prescribe. All administrative and penalty provisions of Title VIII of this Act, in so far as applicable, shall apply to the collection of any tax which the Commissioner of Internal Revenue determines or prescribes shall be paid by stamp.

SEC. 1004. That whoever fails to make any return required by this Act or the regulations made under authority thereof within the time prescribed or who makes any false or fraudulent return, and whoever evades or attempts to evade any tax imposed by this Act or fails to collect or truly to account for and pay over any such tax, shall be subject to a penalty of not more than \$1,000. or to imprisonment for not

more than one year, or both, at the discretion of the court, and in addition thereto a penalty of double the tax evaded, or not collected, or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected, in any case in which the punishment is not otherwise specifically provided.

SEC. 1005. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

* * * * *

SEC. 1008. That in the payment of any tax under this Act not payable by stamp a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to one cent.

SEC. 1009. That the Secretary of the Treasury, under rules and regulations prescribed by him, shall permit taxpayers liable to income and excess profits taxes to make payments in advance in installments or in whole of an amount not in excess of the estimated taxes which will be due from them, and upon determination of the taxes actually due any amount paid in excess shall be refunded as taxes erroneously collected: *Provided*, That when payment is made in installments at least one-fourth of such estimated tax shall be paid before the expiration of thirty days after the close of the taxable year, at least an additional one-fourth within two months after the close of the taxable year, at least an additional one-fourth within four months after the close of the taxable year, and the remainder of the tax due on or before the time now fixed by law for such payment: *Provided further*, That the Secretary of the Treasury, under rules and regulations prescribed by him, may allow credit against such taxes so paid in advance of an amount not exceeding three per centum per annum calculated upon the amount so paid from the date of such payments to the date now fixed by law for such payment; but no such credit shall be allowed on payments in excess of taxes determined to be due, nor on payments made after the expiration of four and one-half months after the close of the taxable year. All penalties provided by existing law for failure to pay tax when due are hereby made applicable to any failure to pay the tax at the time or times required in this section.

SEC. 1010. That under rules and regulations prescribed by the Secretary of the Treasury, collectors of internal revenue may receive, at par and accrued interest, certificates of indebtedness issued under section six of the Act entitled "An Act to authorize an issue of bonds to meet expenditures for the national security and defense, and, for the purpose of assisting in the prosecution of the war, to extend credit to foreign governments, and for other purposes," approved April

twenty-fourth, nineteen hundred and seventeen, and any subsequent Act or Acts, and uncertified checks in payment of income and excess-profits taxes, during such time and under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered.

GENERAL PROVISIONS.

SEC. 1212. That any amount heretofore withheld by any withholding agent as required by Title I of such Act of September eighth, nineteen hundred and sixteen, on account of the tax imposed upon the income of any individual, a citizen or resident of the United States, for the calendar year nineteen hundred and seventeen, except in the cases covered by subdivision (c) of section nine of such Act, as amended by this Act, shall be released and paid over to such individual, and the entire tax upon the income of such individual for such year shall be assessed and collected in the manner prescribed by such Act as amended by this Act.

* * * * *

SEC. 1300. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of said Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

EFFECTIVE DATE OF ACT.

SEC. 1302. That unless otherwise herein specially provided, this Act shall take effect on the day following its passage.

Approved, October 3, 1917.

Effective October 4, 1917.

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